In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. 612

In the Matter of
THE VAN SWERINGEN COMPANY,
Debtor,

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY
(Formerly Midamerica Corporation),
Petitioner,

vs.

THE VAN SWERINGEN COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
for the Seventh Circuit

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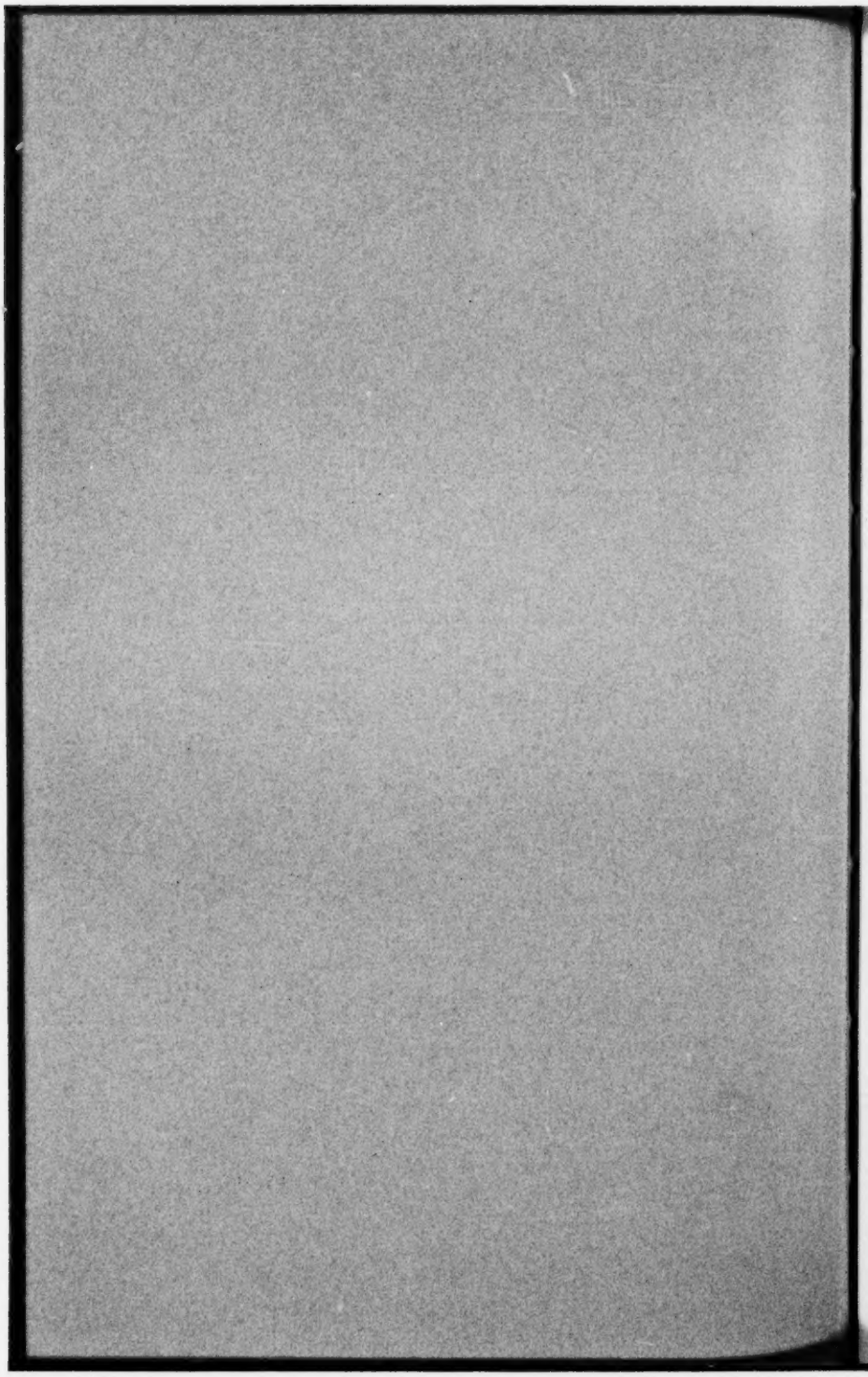

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(Formerly Midamerica Corporation),
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vs.

THE VAN SWERINGEN COMPANY,
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PETITION FOR A WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
For the Sixth Circuit.

The Terminal and Shaker Heights Realty Company (successor by change of name to Midamerica Corporation and hereinafter referred to in this petition and supporting brief as "Midamerica") prays that a writ of certiorari be issued to review an order of the Circuit Court of Appeals for the Sixth Circuit entered in this cause on April 16, 1941. This order affirmed an order of the District Court for the Northern District of Ohio, Eastern Division, disallowing, except for $1.00, a claim by Midamerica against The Van Sweringen Company (hereinafter called "the Debtor") in the principal amount of $6,261,697.59 (amounting with in-

terest to $8,177,023.99). The Special Master to whom the case was referred by the District Court recommended allowance of the claim in full.

Midamerica's petition for a rehearing below was denied on June 25, 1941. (R. 199)*

OPINION BELOW.

The opinion of the Circuit Court of Appeals for the Sixth Circuit (R. 178-186) is reported in 119 Fed. (2d) 231 (1941).

JURISDICTION.

The jurisdiction of this Court is invoked under Section 24(c) of the Bankruptcy Act (U. S. C. A. Title 11, Section 47(c)) and under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. C. A. Title 28, Section 347).

QUESTIONS PRESENTED.

(1) Did Midamerica acquire good title to the notes of the Debtor which it purchased from J. P. Morgan & Co. at public auction sale on September 30, 1935, as a part of the collateral securing a $16,000,000 loan from J. P. Morgan & Co. to The Vaness Company, or was Midamerica debarred from acquiring good title because O. P. and M. J. Van

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* The Circuit Court of Appeals for the Sixth Circuit by the same decision in 119 Fed. (2d) 231 (1941) dealt with the two companion cases of *Midamerica v. Van Sweringen Corporation* and *Midamerica v. The Cleveland Terminals Building Company* and likewise disallowed, except for nominal amounts, claims of Midamerica against Van Sweringen Corporation and The Cleveland Terminals Building Company. In the three cases taken together, claims of Midamerica aggregating $21,248,697, for which all three debtor companies admittedly received full value, were allowed for only $890. Midamerica has filed petitions for certiorari in these two related cases which were argued together below and which involve substantially the same questions of fact and law.

All references are to the record below, except for references to the record in *The Cleveland Terminals Building Company* case, which is designated "C. T. B. record."

Sweringen were officers and directors of Midamerica and also directors of the Debtor?

(2) In the reorganization proceedings of the Debtor under Section 77B (now Chapter X of the Bankruptcy Act), should the rule which forbids a director to profit at the expense of his insolvent company by buying up its notes at a discount be applied to a case where the director did not seek and could not make a profit, but only sought to reduce a personal liability resulting from his guarantee of a $16,000,000 loan to The Vaness Company, for which the notes of the Debtor were pledged as collateral?

(3) Even if O. P. and M. J. Van Sweringen were personally disqualified from buying the notes of the Debtor, was Midamerica also disqualified despite the fact that it was wholly owned by third parties?*

STATEMENT.

In this case directors who had personally guaranteed $39,500,000 of loans to their companies were denied the right, upon foreclosure of the loans, to purchase part of the pledged collateral in order to protect themselves against liability on their guaranties.

(a) The $39,500,000 Loans of J. P. Morgan & Co. to The Vaness Company and The Cleveland Terminals Building Company.

In October, 1930, The Vaness Company, a holding company of O. P. and M. J. Van Sweringen, and its subsidiary, The Cleveland Terminals Building Company (hereinafter called respectively "Vaness" and "C. T. B." in this peti-

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* For the purpose of presenting the reasons why certiorari should be granted, and only for that purpose, Midamerica assumes that it stands in the shoes of the Van Sweringens, and therefore makes no point at this time of Question (3). Midamerica, however, reserves the right, if certiorari is granted, to contend, as it has contended throughout, that wholly different and additional defenses are available to it from those which would be available to the Van Sweringens themselves.

tion and supporting brief) were in serious need of funds, and O. P. Van Sweringen, on their behalf, entered into negotiations with J. P. Morgan & Co. to secure a loan of $16,000,000 to Vaness and $23,500,000 to C. T. B. J. P. Morgan & Co. would not make the requested loans except upon two conditions: (a) that the Van Sweringens personally guarantee payment of both the loans; and (b) that approximately $15,000,000 of debts of Vaness be paid before the loans were made. (R. 96-97; C. T. B. record pp. 123-124, 243, 263.)

Both conditions were met. The $15,000,000 of Vaness debts were cancelled in consideration of their assumption by the Van Sweringens personally, who thereby made a contribution to the surplus of Vaness of nearly $15,000,000 (R. 96-97), and the Van Sweringens personally guaranteed the two loans aggregating $39,500,000, which were made on October 31, 1930. (R. 96-97, 32; C. T. B. record, pp. 123-124, 243, 263.)

The Vaness loan was secured by the pledge of virtually all the securities belonging to Vaness, among which were the $6,261,697.59 principal amount of 6% demand notes of the Debtor, all of whose 122,000 shares of common stock were owned by Vaness. (R. 31-32, 13-16.) These notes represented cash advances by Vaness or its predecessors in interest to or for the account of the Debtor (R. 32), and their enforceability in full in the hands of Vaness has never been questioned.

After 1930, economic conditions became worse.* Vaness and C. T. B. were unable to pay the interest on their loans and, with the consent of the Van Sweringens as guarantors, secured an extension of time for the payment of interest and gave interest notes, also guaranteed by the Van Sweringens. (R. 42; C. T. B. record, pp. 126, 142, 191.) From August, 1934, to the maturity of the loans on May 1, 1935, O. P. and M. J. Van Sweringen made repeated but unsuc-

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* This Court may take judicial notice of this trend, *Great Northern Ry. Co. v. Weeks*, 297 U. S. 135 at 149.

cessful efforts to refund or extend them (R. 97; C. T. B. record, pp. 124, 144-145, 243, 263), and at maturity Vaness, C. T. B. and the Van Sweringens admitted their inability to pay them. (R. 42-43; C. T. B. record, p. 168.)

On September 13, 1935, J. P. Morgan & Co. published a notice of the sale of the collateral securing the Vaness and C. T. B. loans, to be held September 30, 1935. (R. 43-51; C. T. B. record, pp. 52-59.)

The notice of sale divided all the collateral to be sold into 58 parcels comprising four groups. The Debtor's notes were Parcel 23, included in Group 1. The parcels were first to be offered for sale separately and then in groups, and if the group bid exceeded the aggregate of the parcel bids, all the parcels were to be sold as a group. (R. 43-51.) Any bidder desiring to qualify was required to deposit, in cash or by certified check, by 11 o'clock on the day of the sale, the various amounts specified in the notice of sale. The amount required to qualify to bid on Parcel 23 was $250, but the amount required to bid on Group 1 was $270,000. (R. 49-50.)

Groups 1 and 3 comprised securities of the companies which were being managed by the Van Sweringens. (C. T. B. record, p. 177.) The sale was to be conducted by Adrian H. Muller & Son, well known securities auctioneers of New York, and was widely advertised for two weeks in newspapers of general circulation in New York City and widely publicized by news comments throughout the United States. (R. 32-33.) This was in accord with the stated purpose of J. P. Morgan & Co. "to give the widest notice to all possible bidders." (C. T. B. record, p. 176.)

The financial condition of the Debtor at the time of the sale was extremely bad. Although on September 30, 1935, its balance sheet showed solvency, its current position was critical. It had cash in the amount of only $2,525.57. Delinquent real estate taxes, accrued over several years,

amounted to almost $4,000,000; defaulted interest amounted to more than $2,500,000, and on February 3, 1936, within five months after the sale, the Debtor was forced to initiate proceedings for reorganization under Section 77B of the Bankruptcy Act which are still pending. (R. 83, 2.)

(b) The Formation of Midamerica Corporation and the Purchase at the Morgan Auction.

Midamerica was formed on September 28, 1935, for the purpose of bidding at the Morgan public auction sale for the securities of those companies which were being managed by the Van Sweringens. (R. 33-35.) All the capital stock of Midamerica was subscribed for and purchased by George A. Ball of Muncie, Indiana, and G. A. Tomlinson of Cleveland, Ohio, at a cost of $2,015,000, being 20,000 shares of preferred stock at $100 per share, and 15,000 shares of common stock at $1.00 per share. (R. 34, 51-53, 95, 96.) Ball and Tomlinson were willing to invest their money only upon the assurance of continued Van Sweringen management (R. 52, 94, 95); and to this end they granted to O. P. and M. J. Van Sweringen a ten-year non-assignable option to purchase at cost 55% of the common stock of Midamerica at any time when the Van Sweringens could satisfy five of the six directors of Midamerica that they had "paid or adjusted any and all claims" against them based upon existing or future "commitments or relationships." (R. 53.)

The original directors of the corporation, chosen by Ball and Tomlinson as the sole stockholders, were George A. Ball, G. A. Tomlinson, F. B. Bernard of Muncie, Indiana (a close business associate of Ball who had had no previous connection with the Van Sweringens), O. P. and M. J. Van Sweringen, and Charles L. Bradley (a close business associate of the Van Sweringens). (R. 34.)

Even if the Van Sweringens had voted the optioned shares, which they never did (R. 33), they could not have

elected a majority of the board of directors because of the provision in the articles of the corporation for cumulative voting, which limited to three the number of directors which 55% of the common stock could elect. Six directors were provided for and restrictions in the corporate articles and regulations required the vote of five out of these six for (1) enlarging the board, (2) merger, consolidation, or sale of substantially all the corporation's assets, (3) issuance of any new shares, and (4) initiation of any amendments to the corporation's articles or regulations. (R. 33-34, 54-59.) Thus, although the Van Sweringens were the chief executive officers, they did not—and could not—control the board.

O. P. Van Sweringen was elected president and M. J. Van Sweringen vice-president. Other members of the Van Sweringen administrative organization were elected to the other offices. (R. 34.)

On September 30, 1935, at a meeting of the board of directors attended by all the directors except Bradley, it was resolved that the corporation should qualify as a bidder for Group 1 (embracing Vaness collateral) and for Group 3 (embracing C. T. B. collateral) to be sold at the Morgan sale and that the president or his nominee be authorized to bid for all or any part of the securities in Group 1 and Group 3. (R. 62.) The sale was held on the same day, and O. P. Van Sweringen, Tomlinson, Ball and Bernard, of the directors, were present. Colonel Leonard P. Ayres bid at the sale on behalf of Midamerica. (R. 35, 60-63.)

After the securities were offered by parcels, Midamerica made a group bid on the securities in Group 1 and Group 3 which was in excess of the aggregate bids on individual parcels, and all the parcels in these groups were, therefore, sold to it. The purchase price for Group 1 was $2,803,000 and the purchase price for Group 3 was $318,000. (R. 35.) The aggregates of the parcel bids for the respective groups were $2,802,102 and $317,127. (R. 90.) Included in Group 1 were the notes on which the claim

against the Debtor is founded. Also purchased were the common stock of the Debtor, stock and notes of Van Sweringen Corporation, large amounts of stock of Alleghany Corporation (a railroad holding company theretofore controlled by Vaness), and numerous other securities of Van Sweringen enterprises. (R. 44-46.) A list of all the 28 parcels comprising Group 1 appears in Appendix A of petitioner's supporting brief.

For purposes of accounting, it was necessary for Midamerica to establish a cost basis for the securities purchased. Accordingly, on October 31, 1935, J. J. Anzalone, treasurer of Midamerica, requested from the auctioneer a list of the individual bids at the auction. On the basis of this he established a book cost of the various parcels. For those parcels on which there were individual bids he took the individual bids. For those parcels on which there was no individual bid he arbitrarily used the sum of $1.00. However, since the bulk bid exceeded the parcel bids this left an excess of $887, which was arbitrarily assigned to the notes of Van Sweringen Corporation. The entries on this basis were $1.00 for the notes of the Debtor and $887 for the notes of Van Sweringen Corporation. (R. 36, 89-92.)

Inherent in "participation in the management and direction" of Midamerica by the Van Sweringens was the payment to them of a reasonable compensation. The compensation took the form of a drawing account which amounted to $100,000 per year for their joint services. (R. 95.)

Both O. P. and M. J. Van Sweringen were dead before the end of 1936. Each was liable upon indebtedness aggregating more than $50,000,000 (created mainly by their guaranties of the obligations of Vaness and C. T. B.) and each had relatively negligible assets. They died without paying or adjusting any of their debts existing at the time of the formation of Midamerica, and the option died with them. (R. 34, 38.)

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals for the Sixth Circuit erred—

(1) In holding that Midamerica's claim of $8,177,-023.99 against the Debtor should be disallowed except to the extent of $1.00 and in affirming the order of the District Court to that effect;

(2) In holding that the guaranty by O. P. and M. J. Van Sweringen of J. P. Morgan & Co.'s $16,000,000 loan to Vaness had no bearing upon the right of the Van Sweringens to protect themselves against loss and continuing liability through the acquisition of an interest in the Debtor's notes as a portion of the collateral which secured the Vaness loan;

(3) In failing to apply the doctrine of *Twin-Lick Oil Company v. Marbury,* 91 U. S. 587 and *Sanford Fork & Tool Company v. Howe, Brown & Company,* 157 U. S. 312, holding that a director has the right to protect legitimately acquired interests;

(4) In finding that the Van Sweringens realized a profit from Midamerica;

(5) In completely disregarding the corporate entity of Midamerica and treating it as a creature of the Van Sweringens;

(6) In finding bad faith on the part of the Van Sweringens.

REASONS FOR GRANTING THE WRIT.

1. The Decision Below is in Conflict with a Decision of the Circuit Court of Appeals for the Second Circuit on a Matter of Importance in the Administration of the Bankruptcy Act.
2. If the Conflict With the Circuit Court of Appeals for the Second Circuit Relates to a Question Which is Controlled by State Law, the Decision Below is Probably Untenable and is in Conflict With the State Law.

3. The Decision Below Conflicts With Applicable Decisions of this Court and of the Circuit Court of Appeals for the Fifth Circuit on an Important Question in the Law of Corporate Fiduciaries.
4. The Decision Below, by an Overzealous Application of *Pepper v. Litton*, 308 U. S. 295, Ignores Well-Settled Principles of Equity as Declared by This Court and, in Fact, Undermines a Director's Duty of Loyalty.

Petitioner's brief in support of this petition is annexed hereto.

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Respondent.

BRIEF OF PETITIONER
In Support of Petition for a Writ of Certiorari.

In support of its petition for a writ of certiorari in this case, Midamerica files herein its brief and relies upon the reasons listed in its petition as more fully set forth below.

REASONS FOR GRANTING THE WRIT.

1. The Decision Below is in Conflict with a Decision of the Circuit Court of Appeals for the Second Circuit on a Matter of Importance in the Administration of the Bankruptcy Act.

In *In re New York Railways Corporation*, 82 Fed. (2d) 739 (C. C. A. 2, 1936) cert. den. under the name of *Brukenfeld et al. v. New York Railways Corporation et al.*, 298 U. S. 687 (1936) the question was the enforceability in full by the Fifth Avenue Coach Company of bonds of its subsidiary-debtor, the New York Railways Corporation, then

in reorganization under Section 77B. Holding 100% of the common stock and having exclusive voting rights, the parent was a fiduciary. *Southern Pacific Co. v. Bogert*, 250 U. S. 483, 492 (1919). The parent, prior to the 77B proceedings, had purchased $11,000,000, or 54%, of its subsidiary's income bonds at 10% of their face value, and objection was made to the allowance of the parent's claim on these bonds for more than their cost to it. The court held that, because a majority of the debtor's board were "independent" and owed no "allegiance" to the parent, the debtor's failure to acquire its bonds for itself was not owing to improper influence. The parent had not "actively prevented" the purchase of these bonds by the debtor, and hence the court said:

> "The failure of the debtor to so act was undoubtedly due to its financial inability rather than to any other fiduciary faithlessness." (p. 741 of 82 Fed. (2d)).

Here, as in the *New York Railways* case, the failure of the Debtor to acquire its notes was undoubtedly due to its financial inability rather than to fiduciary faithlessness. This is so for two reasons:

(a) Midamerica did not buy the Debtor's notes for $1.00. Midamerica bought 28 parcels of securities in Group 1 for $2,803,000, by a group bid. (R. 35.) In Appendix A hereof appears a tabulation of these 28 parcels as listed in J. P. Morgan & Co.'s notice of sale. On the day of the sale no consideration was, or had been, allocated to the Debtor's notes or to the other twelve parcels within Group 1 for which no individual bids were made. Midamerica's subsequent allocation—for accounting purposes—of $1.00 to each of these parcels (except for the arbitrary allocation of $887 to $13,787,000 of Van Sweringen Corporation Gold Notes) does not establish that Midamerica could have bought, or did buy, these parcels individually for $1.00.

(b) Even if Midamerica's group purchase is interpreted as meaning that Midamerica purchased the Debt-

or's notes for $1.00, neither the record nor sound business judgment warrants the inference that J. P. Morgan & Co. would have sold the Debtor's notes as a separate parcel for $1.00, or, if so, that such a sale would have been made to this Debtor. The qualifying deposit for parcel 23 was $250. The public auction itself was conducted at arms' length, and the Court below, in related litigation involving the validity of J. P. Morgan & Co.'s loan to C. T. B., *Gochenour v. J. P. Morgan & Co.*, 111 Fed. (2d) 378 (C. C. A. 6, 1940), found the sale to be fair and free from collusion. Nor is there evidence to justify the belief that any antecedent plan by the Debtor in advance of the auction to retire more than $6,000,000 of valid indebtedness by bidding a nominal sum would have been reasonable or practicable.

Yet the Debtor has consistently argued—and the two lower courts apparently believed—(i) that because the Debtor had $2,525.27 in cash available, it could have acquired more than $6,000,000 of its notes by bidding $1.00, and (ii) that the Van Sweringens were guilty of gross dereliction in not foreseeing and acting upon this possibility on the Debtor's behalf. It is respectfully urged that this argument ignores realities.

The truth is that here as in *In re New York Railways Corporation, supra,* the failure of the Debtor to act was undoubtedly due to its financial inability and not to prevention by the Van Sweringens or anyone else of a plan by the Debtor to purchase for itself.

It may be contended that the cases are distinguishable in one respect: i.e., the Van Sweringens undoubtedly controlled the Debtor, whereas the court said in the *New York Railways* case that the board of the subsidiary company was independent and that there was no ground to infer from its inaction any improper influence by the parent. This distinction is more apparent than real.

As appears from the opinion, the "independence" of the New York Railway board consisted of the fact (see p.

741 of 82 Fed. (2)) that after a period of admitted domination through interlocking directors, the board was reshuffled shortly before the parent's buying program began—so that thereafter only a minority of the board was interlocking. But it is plain from the course of events that in every practical sense, the parent, with 100% voting rights, controlled its subsidiary.*

Thus the parent's plan for acquisition of the bonds was wholly inconsistent with their acquisition by the subsidiary. The parent knew that its stock investment in the subsidiary was of doubtful value, that reorganization was imminent, and that its continued control was threatened unless it could acquire a majority of the subsidiary's income bonds (p. 741, *ibid*). Yet the court held that its action was entirely proper.

It follows, therefore, that in the Second Circuit a dominant stockholder, who is unquestionably a fiduciary, but who sees its investment and control threatened, may purchase at a discount a majority of its subsidiary-debtor's bonds of a given issue and may thus protect its position by enforcing the bonds in full in subsequent 77B proceedings; provided only that the debtor itself lacks funds for such purchase and that the fiduciary does not "actively prevent" the debtor's purchase on its own behalf. In the Sixth Circuit, on the other hand, dominant directors, under strikingly similar circumstances, must hold what they buy in constructive trust for the debtor.**

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* The identical board, as reconstituted in April, was retained in office by the parent at its annual meeting one month later, and the same board continued in office thereafter for two more years. See Petition for Certiorari, page 12, in the United States Supreme Court, October term 1935, No. 1050, filed by Carl Brukenfeld, Louis Krones and Philip Kerby, as a preferred stockholders committee; see also record in that case 1234, 1236, 1251, 1375, and 1236.

** *In re New York Railways Corporation, supra*, was carefully analyzed and strongly emphasized by the Special Master in his 27-page memorandum to the District Court, recommending allowance in full of Midamerica's claim. (R. 123-124.)

Nor does this divergence between the two circuits concern a question of infrequent occurrence or slight significance in the administration and interpretation of the Bankruptcy Act.

(i) In no less than eleven cases* arising under former Section 77B or present Chapter X of the Bankruptcy Act, the enforceability of a claim has been attacked on the ground that the acquisition of such claim involved a violation of fiduciary duty or kindred inequitable conduct.

These cases do not present fraud, as in *Pepper v. Litton*, 308 U. S. 295 (1939), nor direct dealings by an officer or director with his company as in *Pepper v. Litton*. They are concerned with purchases of claims against the debtor company by officers or directors who acquire such claims from third persons.

Except for claims of landlords, in respect of which this Court has now laid down definitive rules,** the claims of fiduciaries, as shown by the history of Section 77B and Chapter X proceedings, have caused most confusion and

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* *In re McCrory Stores Corporation*, 12 Fed. Supp. 267 (1935); *In re New York Railways Corporation*, 82 Fed. (2d) 739 (C. C. A. 2), cert. den. 298 U. S. 687 (1936); *In re Celotex Co.*, 12 Fed. Supp. 1 (1935); *Security-First National Bank of Los Angeles, et al. v. Rindge Land & Navigation Company, et al.*, 85 Fed. (2d) 557 (C. C. A. 9, 1936); *In re McEwen's Laundry Inc.*, 90 Fed. (2d) 872 (C. C. A. 6, 1937); *In re Radio-Keith-Orpheum Corp.*, 106 Fed. (2d) 22 (C. C. A. 2, 1939); *In re Utilities Power & Light Corp.*, 29 Fed. Supp. 763 (1939); *In re Norcor Manufacturing Company*, 109 Fed. (2d) 407 (C. C. A. 7), cert. den. 310 U. S. 625 (1940); *The Terminal and Shaker Heights Realty Company v. The Van Sweringen Company, The Terminal and Shaker Heights Realty Company v. The Van Sweringen Corporation, The Terminal and Shaker Heights Realty Company v. The Cleveland Terminals Building Company*, all reported in 119 Fed. (2d) 231 (C. C. A. 6, 1941).

** *Kuehner, et al., Trustees, v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 445 (1937); *City Bank Farmers Trust Co., Assignee v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 433 (1937); *Meadows v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 464 (1937); *Schwartz, et al. v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 456 (1937).

uncertainty. Moreover, since investment by corporate officers and directors in the securities of their companies is a widespread and generally understood business practice, the lower federal courts will be increasingly confronted with litigation until definitive rules in this field also have been prescribed by this Court.

(ii) In several of these so-called "fiduciary" cases the lower courts have correctly felt called upon to determine the proper interpretation, scope and effect of two sections of the Bankruptcy Act closely related to the question in this case. Section 202 (U. S. C. A. Title 11, Section 602) provides in material part that the court shall scrutinize the circumstances of an assignment of a future rent claim and the amount of the consideration paid for such assignment in determining the amount of damages allowed the assignee thereof. Section 212 (U. S. C. A. Title 11, Section 612) provides in material part that, in the case of any agent or committee purporting to represent creditors or stockholders, the court may limit any claims or stock acquired by such agent or committee in contemplation or in the course of a proceeding under Chapter X to the actual consideration paid therefor.

One or the other of these sections (set forth in Appendix B hereof) or their predecessors in Section 77B were the subject of careful consideration in four of the cases above noted, i.e., *In re McCrory Stores Corporation, In re McEwen's Laundry, Inc., Security-First National Bank of Los Angeles, et al. v. Rindge Land & Navigation Co.,* and *In re Celotex Co.,* all *supra.*

The reason for this is plain: Section 212 is a legislative declaration that where claims or stock are acquired by an agent or committee in a representative capacity under circumstances which may involve breach of fiduciary duty, the claimant shall not enforce the claim or stock for more than its cost to him. Section 202 relates to assignment of landlords' claims under circumstances which, as a

practical matter, are apt to involve a breach of fiduciary duty. See *In re McCrory Stores Corporation, supra,* the earliest and most frequently cited case in this field.

Consequently, the interpretation and correct application of these two specific provisions of the Bankruptcy Act will in all probability be influenced by the decision of this case.

(iii) It follows from (i) and (ii) above that the present question—although it probes deeply into the law of corporate fiduciaries—is not merely a question of state or local law. Midamerica recognizes that under the decision in *Ruhlin v. New York Life Insurance Co.,* 304 U. S. 202 (1938), conflict among the circuits on the same matter "is not of itself a reason for granting a writ of certiorari" (p. 206, *ibid*) because, since *Erie Railroad Co. v. Tompkins,* 304 U. S. 64 (1938), such conflict "may be merely corollary to a permissible difference of opinion in the state courts." (p. 206 of 304 U. S.)

In the present instance, however, the conflict does not concern a purely local matter like the construction of an insurance contract as in the *Ruhlin* case, *supra,* but on the contrary strikes to the heart of the administration of a national law. The purpose and effect of the Federal reorganization statutes in supplanting equity receiverships is familiar history, *Continental Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co. et al.,* 294 U. S. 648, 672 (1935); and the result is that the Federal courts, sitting in bankruptcy and reorganization proceedings, are the forum in which the validity of discount purchases of claims by corporate officers and directors is today tested with the greatest frequency. The volume of litigation in the Federal courts on the subject of discount purchases by fiduciaries has previously been noted (p. 15, *supra*). In two specific sections of the Bankruptcy Act, Sections 212 and 202, dealing with analogous situations, Congress has itself legislated on this subject. Thus, for example, if the

present case had been one arising under Section 212 and the Debtor, by favor of that specific section, had set up precisely the same defense as here, the "construction and validity" of a provision of the Bankruptcy Act would in all probability have been squarely involved.*

The Federal Constitution (Article 1, § 8, Cl. 4) vests Congress with the power "to establish * * * uniform Laws on the subject of Bankruptcies throughout the United States." This Court, in varying factual situations, has expressly recognized the desirability of adhering to a policy of uniformity so far as possible. In *Kreitlein v. Ferger,* 238 U. S. 21 (1915) the Court (in considering an objection to a sufficient listing of a creditor's name) said:

> "* * * This objection is more difficult of solution than any of the others presented by this record. But, like them, it must be considered in the light of the fact that the statute was intended for business men and should receive not only a practical but a uniform construction. Its provisions are applicable to creditors who live in the country, in villages, in towns and cities. * * * " (p. 30 of 238 U. S.)

Cf. *Local Loan Co. v. Hunt,* 292 U. S. 234, at page 245 (1934).

This view has been echoed in the lower federal courts. In *In re Bockhaus,* 177 Fed. 141, C. C. A. 7 (1910), the court, pointing out that the Bankruptcy Act is "a national act" and was intended to eliminate as far as possible "the confusion and harassment attendant upon a multiplicity of variant local laws" used the following language:

> "* * * Therefore the act in all its parts ought to be interpreted in a national view, doing away as far as possible with the variances of the local laws. * * *" (p. 145, *ibid.*)

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* (Cf. the group of decisions of this Court cited in the second footnote on p. 15, involving the "construction and validity" of the sections dealing with landlords' claims.)

Midamerica submits that the foregoing interpretation of the act is sound and not in derogation of *Erie Railroad Co. v. Tompkins* and that the concept of state law under the doctrine of *Erie Railroad Co. v. Tompkins* should not be expanded in doubtful cases in such a way as to produce unnecessary confusion in the administration of a national act.

Midamerica points out, moreover, that such confusion, produced by the absence of clear principles of guidance, may frequently have the result in the various circuits—as was the fact here—of seriously delaying corporate reorganizations. Such a result is contrary to the intent of Congress that reorganizations be facilitated as much as possible. *Continental Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co. et al., supra,* at p. 685. Midamerica, therefore, urges that certiorari should here be granted to secure uniformity of decision in a field where uniformity is clearly desirable. *Magnum Import Co. v. Coty*, 262 U. S. 159 (1923).

2. If the Conflict with the Circuit Court of Appeals for the Second Circuit Relates to a Question Which is Controlled by State Law, the Decision Below is Probably Untenable and is in Conflict with the State Law.

If, despite the considerations outlined under subsections (i), (ii) and (iii) above, this Court should conclude that the conflict relates to a question controlled by state law, Midamerica submits, in the alternative, that certiorari should be granted because the decision below is "probably untenable" and "probably in conflict with the state law." (See language of Mr. Justice Reed at p. 206 of *Ruhlin v. New York Life Insurance Co., supra.*)

On the assumption that state law governs, it is clear that, under settled principles of the conflict of laws, the applicable law is either that of New York or of Ohio. New York is the state where the Morgan auction sale was held and where the Van Sweringens acted, or failed to act, in

such a way as allegedly to involve themselves in a breach of fiduciary duty to the Debtor. See *Beale, The Conflict of Laws,* Vol. Two, §§ 377.2, 378.1 *et seq.* Ohio is the state of the Debtor's incorporation. See *Rogers v. Guaranty Trust Company of New York,* 288 U. S. 123 (1933).

If the law of New York governs, the decision below was clearly in conflict with that law as announced in *Tiffany v. Smith,* 124 N. Y. Sup. 85 (1910), being the only New York case on the subject. In *Tiffany v. Smith,* which was strongly relied on by petitioner below, directors who had guaranteed the obligations of their company were permitted to protect themselves upon a judicial sale of the Company's property by buying in the property for themselves, even though they had not discharged their guaranty.

If the law of Ohio governs, we are remitted to the entire body of substantive law on the question, for there is no relevant Ohio authority. There are, of course, general statements in Ohio cases regarding the duty of a director to his corporation, but opposing counsel have not cited—and petitioner has been unable to find—any Ohio case in point on the issue here involved. Midamerica believes, however, that the decision below was probably in conflict with the Ohio law "as yet unannounced by the highest court of the state" (p. 206 of *Ruhlin v. New York Life Insurance Co., supra*) because that decision was so clearly opposed to the weight of authority.

Relevant decisions of this Court and of the lower federal courts plainly establish the right of a director to protect legitimately acquired interests and to avoid the personal loss and individual liability which would result from the denial of such right in cases where the director has advanced cash or lent credit to his company. These decisions are *Twin-Lick Oil Co. v. Marbury,* 91 U. S. 587 (1875); *Sanford Fork & Tool Co. v. Howe, Brown & Co.,* 157 U. S. 312 (1895); and *Arn v. Bradshaw Oil & Gas Co.,* 108 Fed. (2d) 125 (1940), all of which are analyzed fully under Reasons 3 and 4 below and which, therefore, in the interest of brevity are not discussed at length at this point.

3. The Decision Below Fails to Follow Applicable Decisions of this Court and of the Circuit Court of Appeals for the Fifth Circuit on an Important Question in the Law of Corporate Fiduciaries.

In *Twin-Lick Oil Company v. Marbury*, 91 U. S. 587 (1875), a director in good faith lent money to his corporation and took a mortgage on certain of its property to secure the loan. On default, he foreclosed the mortgage and bought in the property himself. This Court held that he was not accountable for profits later derived from this property; and since this decision, it has been settled law that a director of a corporation may in good faith lend money to it and that the debt thereby created and the security given therefor are valid and enforceable in his hands.

The Court started from the premise that the loan itself was proper. It then reasoned as follows: (i) Since the loan was valid, the director could properly take security. (ii) Since he could take the security, he had a right to enforce it. The case thus stands for the obviously fair doctrine that where a director, acting throughout in entire good faith, acquires valid rights against his company, he may take appropriate steps to protect those rights, and his action in so doing is not inconsistent with his duty of loyalty. Midamerica invokes this doctrine here.

Through personally guaranteeing the $16,000,000 Morgan loan to Vaness in 1930, the Van Sweringens in good faith lent their credit to Vaness. Vaness was a parent holding company which owned 100% of the Debtor's common stock and which (together with its predecessor in interest) had advanced to the Debtor, or paid for the Debtor's account, $6,261,697.59 in cash, being the advances represented by the notes which are now the subject of Midamerica's claim. (R. 32.) Because of this guaranty, the Van Sweringens not only risked the complete loss of their investment in Vaness (to which they had made a capital

contribution of nearly $15,000,000 (R. 97) and 80% of whose common stock they owned (R. 33)), but also they pledged their personal resources to the extent of any deficiency which might result on foreclosure of the Morgan loan of $16,000,000 to Vaness.*

From the beginning, therefore, the Van Sweringens as guarantors were profoundly concerned with the aggregate value of all the pledged collateral. Their contingent liability rose and fell as its value fluctuated up and down, and finally became fixed when its value became fixed on the day of the public auction on September 30, 1935. The Van Sweringens' economic and equitable interest in the collateral was thus obvious and unquestioned and justified their attempt to minimize probable heavy loss by acquiring some share in it.

Their attempt, of course, failed. The Van Sweringens at the time of the auction were hopelessly insolvent, with relatively small assets and with liabilities (arising mainly from guaranties of debts of their companies) which totalled more than $50,000,000. (R. 38-39.) M. J. Van Sweringen died within two months, owing $68,000,000. (R. 38.) O. P. Van Sweringen died within a year and two months, owing $80,000,000. (R. 38.) They had not, and could not have, exercised the option. But the very hopelessness of their endeavors to save themselves from total ruin shows how plainly the court below disregarded the record in concluding that the Van Sweringens somehow made a profit from Midamerica.

Until the Van Sweringens had discharged their guaranties, they could make no profit from Midamerica and, indeed, they had no reasonable possibility of making such a profit at any time. Certainly they made no profit from their

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* Vaness had also guaranteed the $23,500,000 Morgan loan to C. T. B., and consequently all the assets of Vaness, as well as all the personal credit of the Van Sweringens, were back of both loans. (C. T. B. record, pp. 124, 243.)

option, which was never exercised because it could only be exercised after the payment or adjustment of all their debts, including their guaranties. Certainly they made no profit from a drawing account which was given as compensation for management of the valuable railroad properties, which has never been attacked as unreasonable, and which would have been precisely the same irrespective of Midamerica's acquisition of the Debtor's notes. Consequently, *Magruder v. Drury*, 235 U. S. 106 (1914), and *Jackson v. Smith*, 254 U. S. 586 (1921), holding that a fiduciary and his associates are liable for profits realized from their dealings with the beneficiary, are irrelevant, and the reliance of the court below on these cases was error.

The court below dismissed the entire foregoing argument in one paragraph, citing an Ohio case which did not even involve a guaranty.

> "From the premise that the *Twin-Lick Oil Company* case, *supra*, establishes the right of a director to protect a validly acquired interest as against his corporation, appellant earnestly insists that it should prevail in these suits. We cannot concur. The mere fact that the Van Sweringens were endorsers and guarantors of heavy obligations of the corporations in which they were directors does not avoid the effect of the doctrine that they should not be permitted, directly or indirectly, to derive from their position personal profit or advantage not shared by all stockholders. See *Thomas v. Matthews*, 94 O. S. 32, 43."

Twin-Lick Oil Company v. Marbury, supra, clearly demonstrates the incorrectness of this view, because the very basis of this decision is that a director who has lent his credit to his company acquires by virtue of that fact important contract and property rights which otherwise he would not possess. *Twin-Lick Oil Company v. Marbury* was cited with approval in *Allen v. Gillette*, 127 U. S. 589 (1888), and in *Starkweather v. Jenner*, 216 U. S. 524 (1910), to sustain the proposition that even an express trustee may

purchase trust property at a judicial sale which he has taken no part in procuring and over which he had no control.

Moreover, the Circuit Court of Appeals for the Fifth Circuit in a recent decision relies in part upon the doctrine of *Twin-Lick Oil Company v. Marbury* to sustain a purchase of corporate property against the charge of breach of fiduciary duty. The case is *Arn v. Bradshaw Oil & Gas Co.*, 108 Fed. (2d) 125 (1940), cert. den., 310 U. S. 646. Here a bank holding a first mortgage given by an oil company foreclosed the mortgage and bid in the property at judicial sale. A few days later, by a separate and independent transaction, it resold the property to the Bradshaw Company, which had been formed for this purpose by a group of second-lien creditors of the oil company. Bradshaw, who was president of the new company, had been a director of the oil company and had formerly been associated with one of the largest second-lien creditors. Boyd, who owned a stock interest in the new company, had also been a director of the oil company and continued to be associated with another second-lien creditor. Stockholders of the oil company contended that the position of Bradshaw and Boyd resulted in a violation of their fiduciary duty to the oil company.

The court held to the contrary, citing as one of three relevant decisions by this Court, *Twin-Lick Oil Company v. Marbury, supra.** Among the facts emphasized in the opinion are three in which the *Arn* case closely resembles the case at bar: (a) all the directors of the oil company "did their best" for the oil company prior to the sale (p. 127 of 108 Fed. (2d)); (b) none of the directors of the oil company brought about the foreclosure sale or contributed to it (p. 127, *ibid*); (c) the purchase by the second-lien creditors in order "to recover if possible" their debts

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* The other two cases cited are *Michaud v. Girod*, 4 How. 503 (1845) and *Stephen v. Beall*, 22 Wall. 329 (1874).

against the oil company was not an abuse by the directors of their office (p. 128, *ibid*).

Thus *Twin-Lick Oil Company v. Marbury*, as interpreted by later decisions of this Court and by at least one Circuit Court of Appeals, stands for the principle (in no way inconsistent with a director's duty of loyalty to his corporation) that a director may protect validly acquired rights. Unless this principle is to be narrowly confined to the simple case of a cash loan and sternly rejected in the case of a credit loan, it should govern here.

If the Van Sweringens had been financially able to pay the loan to Vaness and so discharge their guaranty, they would have acquired indefeasible rights in the pledged collateral.* In equity the Van Sweringens, because they continued to remain liable on their guaranties, stand in the same position *with respect to this Debtor* (which could not have received any part of such payment) as if they had paid the loan.

As this Court said in the *Twin-Lick Oil Company* case:

> "Defendant was at liberty to bid, subject to those rules of fairness which we have already conceded to belong to his peculiar position; for, if he could not bid, he would have been deprived of the only means which his contract gave him of making his debt out of the security on which he had loaned his money." (pp. 590-591 of 91 U. S.)

So here, to deny the Van Sweringens the right to buy the Debtor's notes at a free, open and public sale would be to deprive them of their only means of reducing their deficiency liability as guarantors and would nullify in large measure the right of a guarantor or surety to look for protection to the collateral pledged by the principal obligor.

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* *Leavenworth County Comm'rs v. C. R. I. & P. Ry.*, 134 U. S. 688 (1890); *Sanford Fork & Tool Company v. Howe, Brown & Company*, 157 U. S. 312 (1895); *Fitzgerald and Mallory Construction Co. v. Fitzgerald*, 137 U. S. 98 (1890).

4. The Decision Below, by an Overzealous Application of Pepper v. Litton, 308 U. S. 295, Ignores Well-Settled Principles of Equity as Declared by this Court and, in Fact, Undermines a Director's Duty of Loyalty.

Although the evident purpose of the opinion below is to enforce vigorously a director's duty of loyalty to his corporation in accordance with the recent enunciation of this well-settled duty in *Pepper v. Litton, supra,* the effect of the opinion will be precisely the opposite. The decision, if allowed to stand, will tend to have a widespread, undesirable influence on the attitude of corporate directors because of the very extremes to which it goes and because of the changed judicial attitude which it evidences toward directors who have pledged their entire personal resources for their corporation.

In *Sanford Fork & Tool Company v. Howe, Brown & Company,* 157 U. S. 312 (1895)* this Court clearly confirmed the right of a director-guarantor to protect himself against loss upon his guaranty. In that case the Court had under consideration the validity of a mortgage given by a corporation while insolvent, although still a going concern, in order to protect its directors from liability on account of their personal guaranty of the corporation's notes. In the course of its opinion this Court made the following observation, which is especially pertinent to the circumstances under which the Van Sweringens executed the guaranties here involved:

> "* * * The mortgage was not given simply as security for a past indebtedness, but to induce the indorsers to obtain for the corporation a renewal or extension of

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* The *Sanford* case was cited to the court below as one of 16 decisions (collected in the appendix to Midamerica's main brief below) which involved guaranties by a fiduciary and in which the fiduciary's purchase of corporate property or debt was upheld. The *Sanford* case was followed in *Geisenberger & Friedler et al. v. Robert York & Co. et al.,* 262 F. 739 (C. C. A. 5, 1919) and *In re Federal Coal Co.,* 31 F. (2) 375 (1927).

its obligations, and to make further indorsements. In reliance upon this mortgage the indorsers secured renewals or extensions, or themselves took up the notes they had indorsed, and at the same time lent the credit of their names to new paper of the company. *Thus they prevented a suspension of the business and enabled the corporation to continue its operations, and did so believing that by such continuance the corporation would be enabled to work itself out of its temporary difficulties. All this was done in the utmost good faith.*" (pp. 316, 317 of 157 U. S.)

* * * * *

"We are of opinion that these facts clearly and fully distinguish this case from many which have been cited, in which the action of the directors of a corporation in securing to themselves preferences in the hour of its extremities has been adjudged void, *and that it is going too far to hold that a corporation may not give a mortgage to its directors who have lent their credit to it, to induce a continuance of the loan of that credit, and obtain renewals of maturing paper at a time when the corporation, though not in fact possessed of assets equal to its indebtedness, is a going concern, and is intending and expecting to continue in business.* We are, therefore, of opinion that the Circuit Court erred, * * *." (p. 320, *ibid.*) (Emphasis supplied.)

Under this decision the Van Sweringens would have been entitled, for their own protection, to take a second mortgage on the Vaness and C. T. B. assets pledged with Morgan. Under this decision the Van Sweringens, in guaranteeing the loans to Vaness and C. T. B., unquestionably acted in good faith. Yet the court below found that "bad faith and breach of fiduciary duty were implicit" in the purchase by the Van Sweringens of the collateral securing the guaranteed loans and further held that the Van Sweringens were not entitled, as "endorsers and guarantors of heavy obligations" of their corporations, to protect themselves against liability. (R. 179, 185.)

If the opinion below is allowed to stand, directors will know that in the Sixth Circuit their duty of loyalty is a dangerous duty. They will know that they act at their peril in pledging their personal credit on behalf of their companies—however urgent the need and however wise the pledge from a business standpoint. They will know that although previously courts have encouraged a director's willingness to risk his own resources for the sake of the corporate enterprise,* today this outlook no longer prevails. They will know finally that all fiduciaries are lumped indiscriminately into one large class; that the right to protect a legitimate interest (which is the underlying theme of *Twin-Lick Oil Co. v. Marbury, Sanford Fork & Tool Company v. Howe, Brown & Company,* and *In re New York Railways Corp.,* all *supra*) is no longer extended to corporate directors; and that a rule which in equity and fairness has previously been applied only to profit-seeking volunteers (having no pre-existing interest to protect) is now applied even to directors who, because of their position as guarantors or sureties, seek simply to reduce overwhelming losses and to minimize enormous liabilities.

CONCLUSION.

It is respectfully submitted that this Court should grant Midamerica's petition for a writ of certiorari in order (a) to resolve a conflict of decision between the Circuit Courts of Appeals of the Second and Sixth Circuits on a matter of importance in the administration of the Bankruptcy Act, or, in the alternative, to resolve a conflict between the decision below and the applicable state law, and (b) to remove the doubt, confusion and uncertainty which have been engendered in the law of corporate fiduciaries

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* As the Court said in *Arn v. Operators Royalty & Producing Co.*, 13 Fed. Supp. 769, 773 (1936), an officer who has made a loan in good faith "* * * should be commended rather than condemned for the action * * *."

through overzealous application by the court below of *Pepper v. Litton* and its failure to follow the equitable principles laid down in *Twin-Lick Oil Co. v. Marbury, Sanford Fork & Tool Company v. Howe, Brown & Company,* and *Arn v. Bradshaw Oil & Gas Co.*

William H. Thompson,
Everett Warner,
Charles S. Wachner,
Counsel for Petitioner.

APPENDIX A.

GROUP 1.

	Security Purchased	Individual Parcel Bid	Market Value[1]
1.	100,000 shares of common stock of Alleghany Corporation	$ 50,000	$ 137,500
2.	"	40,000	137,500
3.	"	30,000	137,500
4.	"	20,000	137,500
5.	"	10.000	137,500
6.	"	12,914	177,556
7.	6,915 shares of preferred stock, Series A, of Alleghany Corporation	28,933	34,011
8.	10,000 shares of the capital stock of Cleveland Railway Company	598,800	640,000
9.	"	598,800	640,000
10.	"	598,000	640,000
11.	10,393 shares of the capital stock of Cleveland Railway Company	622,540	665,152
12.	250 shares of the capital stock of Huron-Fourth Company	1,250	no market value
13.	196 shares of the capital stock of The Long Lake Company	none	no market value
14.	17,000 shares of the capital stock of Terminal Building Company	none	no market value
15.	122,000 shares of the common stock of the Debtor	none	no market value
16.	1,244,580 shares of the common stock of Van Sweringen Corporation	none	no market value
17.	$139,000 certificates of deposit representing bonds of Alleghany Corporation	29,885	31,970
18.	$270,000 second mortgage bonds of The Cleveland Terminals Building Company	none	no market value
19.	$817,460.36 demand notes of The Long Lake Company	25,000	no market value
20.	$278,204.84 demand notes of Metropolitan Utilities, Inc.	none	no market value
21.	$207,176.60 demand notes of Terminal Building Company	none	no market value
22.	$170,430.29 demand note of The Terminal Hotels Company	none	no market value
23.	*$6,261,697.59 demand notes of the Debtor*	*none*	*no market value*
24.	$13,787,000 gold notes of Van Sweringen Corporation	none	no market value
25.	$554,103 demand notes of Van Sweringen Corporation	none	no market value
26.	$2,595,398.85 subordinated note of Van Sweringen Corporation	none	no market value
27.	$1,292,534.72 subordinated note of The Higbee Company	83,333	no market value
28.	$69,673.71 participation in $523,043.51 note of The Higbee Company	52,256	no market value

[1] Computed on the basis of the lowest sale price on September 30, 1935, or, if there were no such sale, the bid price on that date on the exchange (New York or Cleveland) on which the security was listed. Petitioner recognizes, of course, that the Alleghany, Cleveland Railway, and Pittston securities could not have been sold in large blocks at the prices indicated.

The market quotations relating to the Alleghany common stock and the Cleveland Railway stock are based on the record. (R. 36.) The quotations relating to the other listed securities are based on "The Commercial & Financial Chronicle" for September, 1935.

APPENDIX B.

11 U. S. C. A. § 602. *Rejection of executory contract or unexpired lease; assignment of future rent claim.*

In case an executory contract shall be rejected pursuant to the provisions of a plan or to the permission of the court given in a proceeding under this chapter, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity in a prior pending proceeding, any person injured by such rejection shall, for the purposes of this chapter and of the plan, its acceptance and confirmation, be deemed a creditor. The claim of the landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be provable, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by such lease for the three years next succeeding the date of the surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid accrued rent, without acceleration, up to such date of surrender or reentry: *Provided,* That the court shall scrutinize the circumstances of an assignment of a future rent claim and the amount of consideration paid for such assignment in determining the amount of damages allowed the assignee thereof. July 1, 1898, c. 541, § 202, as added June 22, 1938, c. 575, § 1, 52 Stat. 893.

11 U. S. C. A. § 612. *Same; regulation by court.*

The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor. July 1, 1898, c. 541, § 212, as added June 22, 1938, c. 575, § 1, 52 Stat. 895.

Office - Supreme Court, U. S.
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OCT 4 1941
CHARLES ELMORE CROPLEY
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. 612.

IN THE MATTER OF:

THE VAN SWERINGEN COMPANY,

Debtor.

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY,
(formerly Midamerica Corporation),

Petitioner,

vs.

THE VAN SWERINGEN COMPANY,

Respondent.

BRIEF OF RESPONDENT
In Opposition to Petition for Writ of Certiorari.

EDWARD T. BUTLER, JR.,
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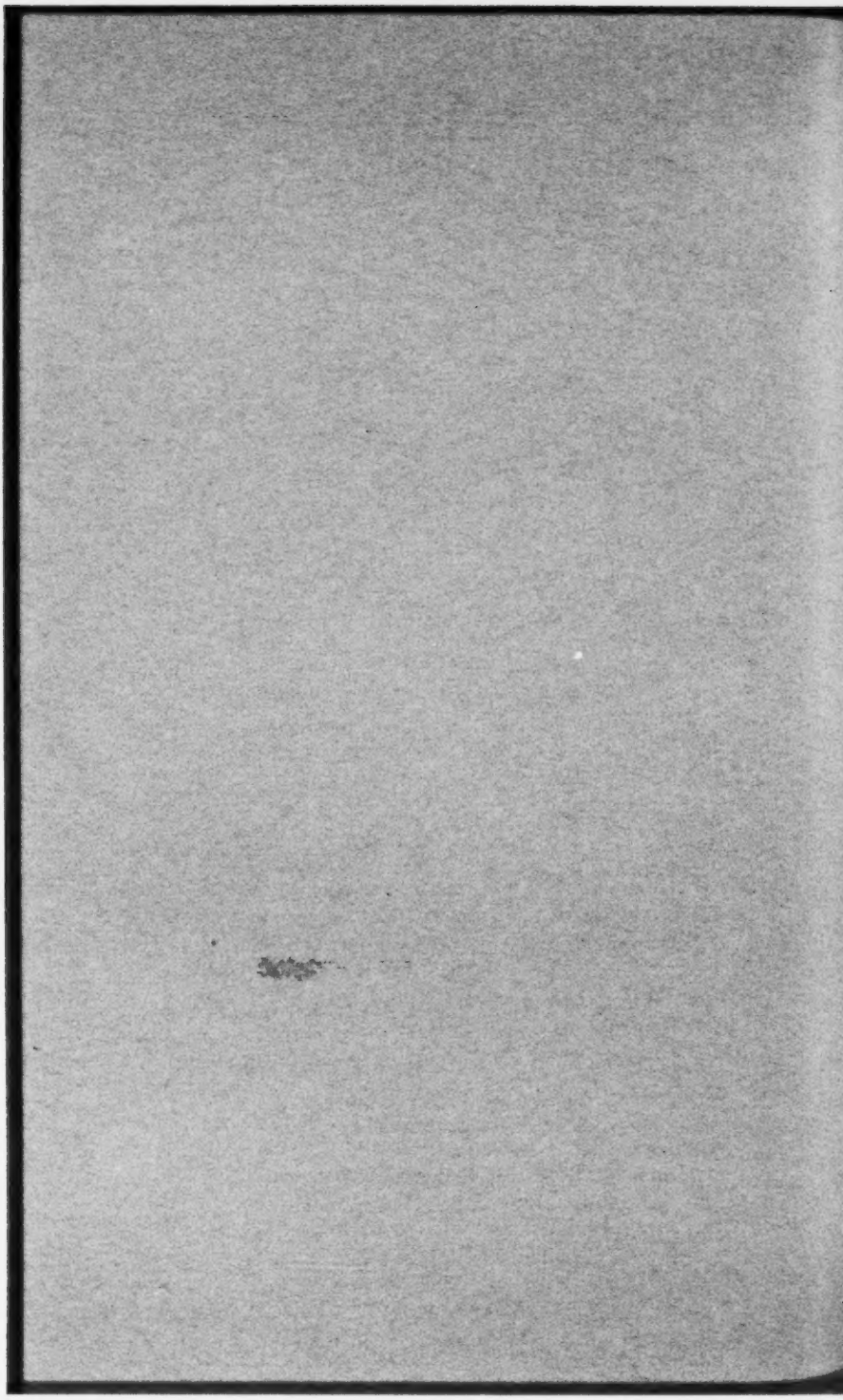

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In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. 612.

IN THE MATTER OF:

THE VAN SWERINGEN COMPANY,

Debtor.

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY,
(formerly Midamerica Corporation),

Petitioner,

vs.

THE VAN SWERINGEN COMPANY,

Respondent.

BRIEF OF RESPONDENT
In Opposition to Petition for Writ of Certiorari.

The Respondent respectfully submits this brief to the Court in opposition to the petition for a Writ of Certiorari. The Petitioner, The Terminal and Shaker Heights Realty Company, will be referred to herein as "Midamerica," and the Respondent, The Van Sweringen Company, as "Debtor." This brief will treat in the order of Midamerica's petition and brief some of the parts of Midamerica's petition and all of the parts of Midamerica's brief.

PETITION FOR WRIT OF CERTIORARI.

The Debtor cannot concur in all of the statements and allegations of Midamerica's petition for a Writ of Certiorari and believes that in the interest of accuracy and justice a restatement of some portions of the petition should be made. To that end the Respondent represents the following:

1. QUESTIONS PRESENTED.

The second of the questions presented (Midamerica's petition) is not as stated by Midamerica but rather—

> (2) In the reorganization proceedings of the Debtor under Section 77-B of the Bankruptcy Act, should the rule which forbids Directors to profit at the expense of their insolvent company, by buying its notes at a discount, be applied to a case in which the directors, for selfish reasons, make their possibility of profit contingent upon self imposed and waivable conditions, utilize a self-created corporate intermediary and claim an interest in the notes through stock ownership in an insolvent corporation and a guarantee of the debt for which the notes were pledged, upon which guarantee they neither paid nor could pay anything?

2. STATEMENT.

The statement of the facts (Midamerica's petition), while it in no particular statement is inconsistent with the statements in the record below, as a whole does not present the same complete factual situation for which Debtor contends and which the Courts below found. Debtor believes that the following statement of facts more accurately and more completely sets forth the factual situation.

A. Fiduciary Relationships.

The Debtor is an Ohio corporation engaged in the development and sale of real estate. (R. 2.) All of its common and about one-third of its preferred shares were owned by The Vaness Company (hereinafter called "Vaness"). (R. 31.) O. P. and M. J. Van Sweringen at all material times were Directors of the Debtor and officers and Directors of Vaness (Stipulation Exhibit "B," R. 40-41, introduced R. 32), and with B. L. Jenks and D. S. Barrett, officers of Vaness, constituted four of the five Directors of the Debtor. (R. 40-41.) The Van Sweringens owned 80% of the common shares and claimed a benefi-

cial interest in 56% of the preferred shares of Vaness. (R. 31.) The Van Sweringens controlled, managed and directed the business and affairs of the Debtor. (Stipulation Exhibits "B" & "D," R. 40-41 and 51-52, introduced R. 32-33.)

B. The Notes on Which the Claim is Founded.

The Appellant's claim is upon notes issued by the Debtor in the face amount of $6,261,697.59 (amounting, with interest, to $8,177,023.99), representing cash theretofore advanced by Vaness or its predecessors in interest to and for the account of the Debtor. They are 6% demand notes and were pledged with J. P. Morgan & Company as part of the collateral security for a loan to Vaness from J. P. Morgan & Company in the amount of $16,000,000.00, dated October 31, 1930. This loan was guaranteed by the Van Sweringens personally (R. 13-16 and 32), but nothing was paid under the guaranty.

C. The Formation of Midamerica.

On May 1, 1935, the Van Sweringens and Vaness notified J. P. Morgan & Company that Vaness and the Van Sweringens were unable to pay the Vaness loan other than by resort to sale of the security pledged. In August, 1935, the Van Sweringens went to Ball and Tomlinson and instituted negotiations leading to the formation of Midamerica Corporation. (R. 33.) The Van Sweringens appealed to G. A. Ball for help. The Van Sweringens discussed the securities to be offered for public sale. Ball and the Van Sweringens had repeated conferences concerning the properties and securities and the management of the companies involved. The discussions between the Van Sweringens and Ball culminated in an agreement between the Van Sweringens and G. A. Ball and G. A. Tomlinson dated September 21, 1935. (Stipulation Exhibit "D," R. 51-53, introduced R. 33.) This agreement provided for the incor-

poration of Midamerica and the purchase by Midamerica of the notes involved in this case and other securities. (R. 51-53.) As part of said agreement the Van Sweringens obtained an option to purchase 8,250 common shares of Midamerica (55%), and the right to vote the shares during the option period. In order that the interest of the Van Sweringens in Midamerica be kept beyond the reach of their creditors, the option was non-assignable and in keeping with the expressed desires of the Van Sweringens (R. 53), the exercise of their option to acquire 55% of the common shares of Midamerica (8,250) for $8,250.00, plus interest at 5%, was conditioned that five of the six directors of Midamerica be satisfied that the Van Sweringens had paid or adjusted any and all claims based upon then existing commitments or relationships. (R. 52-53.) Pursuant to this agreement dated September 21, 1935, Midamerica was incorporated on September 28th, 1935. Ball and Tomlinson subscribed for 20,000 preferred shares and 15,000 common shares.

In accordance with their said agreement, the original Directors of the corporation were G. A. Ball, G. A. Tomlinson, F. B. Bernard, O. P. Van Sweringen, M. J. Van Sweringen and Charles L. Bradley. (R. 34 and 55.) The officers elected at the first meeting of Directors were O. P. Van Sweringen, President, M. J. Van Sweringen, Vice-President, and other members of the Van Sweringen administrative organization who were acting as officers or directors of Vaness or the Debtor. The Van Sweringens, by their agreement, had a drawing account by way of salary from Midamerica in the amount of $100,000.00 per year. (R. 95.)

D. Purchase of the Notes.

On September 13, 1935, J. P. Morgan & Company published a notice of the sale of the collateral securing the Vaness loan. This sale was advertised and was set for September 30, 1935. The notice of sale divided the col-

lateral into four groups. The notes in question were Parcel 23 of Group 1. The notice of sale (Stipulation Exhibit "C," R. 43-51, introduced R. 32) shows the grouping of parcels. Groups 1 and 3 comprised securities of the companies which were controlled and managed by the Van Sweringens. Adrian H. Muller & Son, Auctioneers, conducted the sale. (R. 32-33.) On September 30, 1935, at a meeting of the Board of Directors of Midamerica it was resolved that the corporation qualify as bidder and that the President, O. P. Van Sweringen, be authorized to bid for and purchase all or any part of the securities included within said Group 1 and/or said Group 3, at such price or prices as he may determine. (Stipulation Exhibit "H," R. 60-63, introduced R. 35.) O. P. Van Sweringen, Ball, Tomlinson and others attended the sale. The actual bidding was done by Col. Leonard P. Ayres on behalf of O. P. Van Sweringen for Midamerica Corporation. (R. 35.)

At the auction sale neither the Debtor, Midamerica, nor any other party made a separate bid for Item 23 of Group 1 (the notes in question). (Stipulation Exhibit "N," R. 90, introduced R. 36.) Midamerica made no bids for the individual items included in Group 1. It bid $2,803,000.00 for Group 1, which was $898,000 more than the aggregate of the separate bids made by others. The securities comprising Groups 1 and 3 were awarded to Midamerica on its group bids.

E. The Cost Price of the Notes.

After purchasing the notes in question and the other securities at the Morgan sale, Midamerica recorded the transaction in its books of account. (Stipulation Exhibit "O," R. 91-92, introduced R. 36.) It allocated a part of the aggregate purchase price to each item of the securities purchased. It determined the cost price of the notes in question to be $1.00. (R. 92.) One of Midamerica's stated reasons for journalizing the cost of the securities

in this manner was to substantiate its costs for tax purposes. (Stipulation Exhibit "M," R. 89, introduced R. 36-37.) All of the securities in Group 1 purchased, including the notes in question, were recorded in the same entry, a separate itemization being made for each class of securities. Midamerica used this cost determination in computing its income taxes in connection with the sale of shares of Cleveland Railway Company acquired with the notes in question here and the purchase of which was recorded with said notes.

F. Insolvency of the Debtor.

The balance sheets dated September 30, 1935 (Stipulation Exhibit "L," R. 83-87, introduced R. 35) show that the Debtor on the date of the purchase by Midamerica of the notes in question at the Morgan sale was insolvent. This balance sheet and the other balance sheets included in the record (Stipulation Exhibits "J, K & L," R. 66-87, introduced R. 35) with explanatory notes attached thereto disclose that the bulk of the assets of the Debtor consisted of real estate, mortgages and land contracts; unsold lots and unallotted properties were carried at more than $25,000,000.00 and were subject to five years unpaid taxes, approximating $4,000,000.00. These same balance sheets and supporting schedules and notes state that no revaluation of the assets had been made to reflect existing conditions. They also show that since prior to 1932, the Debtor had been attempting to refund and extend its bond indebtednesses exceeding $8,000,000.00, and that substantially all of the indebtedness of the Debtor was past due by 3½ years, and that Debtor had not sufficient liquid assets with which to meet its obligations as they were currently accruing. The petition of the Debtor for reorganization (R. 2-4) alleges as a jurisdictional fact that the Debtor was insolvent under the equity definition.

G. Miscellaneous.

Midamerica never offered to Debtor the opportunity to acquire the notes of Debtor purchased by it. (R. 38.) No notice was given to the creditors of Debtor of either the auction sale or the agreement of September 21, 1935, referred to above, and the Van Sweringens took no action whatsoever to acquire the notes at the sale for the Debtor.

3. SPECIFICATION OF ERRORS.

Respondent represents to the Court that the courts below did not commit the errors charged in the Specification of Errors (Midamerica's petition) or any other errors. Respondent represents that the Specification of Errors in addition is not accurate in Items 4 and 5 thereof, in that the court below did not find that the Van Sweringens realized a profit; rather, they found that there was a possibility of their realizing a profit through the allowance of the claim in the amount claimed. Also, the court below did not disregard the corporate entity of Midamerica but rather found Midamerica to be a medium used by the Van Sweringens for the realization of a profit and that therefore Midamerica could not be permitted to realize a profit which was forbidden to the Van Sweringens.

ANSWER TO ARGUMENT IN PETITIONER'S BRIEF.

The Respondent will treat herein in the order of Midamerica's brief the arguments advanced by Midamerica as reasons for the granting of the Writ of Certiorari, and respectfully submits that those arguments will be shown to be unsound and invalid.

I. MIDAMERICA'S CLAIM THAT THE DECISION OF THE COURT BELOW IS IN CONFLICT WITH A DECISION OF THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT ON A MATTER OF IMPORTANCE IN THE ADMINISTRATION OF THE BANKRUPTCY ACT.

Midamerica argues that *In re: New York Railways Corporation,* 82 Fed. 2nd, 739, C. C. A. 2, 1936, is a case sufficiently similar to the case at Bar that because of the claimed conflict between the holding in that case and the holdings of the courts below in the case at Bar, a Writ of Certiorari should be granted. Let us examine the cases to determine if the cases are in conflict, and if the cases are similar in their facts. In the case at Bar the courts below held that Midamerica (the creature of the Van Sweringens) could have its claim on the notes of the Debtor in the amount of $8,177,023.99 allowed in the sum of only $1.00 (its cost) against the Debtor in the reorganization proceedings, because in the acquisition of the claim by Midamerica the Van Sweringens (in a fiduciary relationship to the Debtor) breached their fiduciary duty to the Debtor in that they preferred to advance their own possibility of profit through Midamerica rather than to protect their *cestui que trust,* the Debtor, by purchasing the claim for it at a discount. The courts below thus prevented Midamerica from making a profit on a claim acquired through a breach of fiduciary duty.

In the *New York Railways Corporation* case, *supra,* the Court of Appeals held that the Fifth Avenue Coach Company was entitled to allowance in full of its claim in the amount of approximately $11,000,000.00 (the face amount of bonds of the New York Railways Corporation) in the reorganization proceedings of the New York Railways Corporation, although the bonds cost approximately $1,100,000.00, and that there was no breach of fiduciary duty on the part of the Coach Company, which owned 100% of the voting stock of the Railways Corporation, and had

6 out of 16 Directors of the Railways Corporation, and that at the time of the acquisition of the bonds in the open market the Railways Corporation did not have the financial ability to purchase the bonds.

An examination of the facts of the two cases claimed to be in conflict reveals the following:

In the New York Railways Corporation Case.	In the Van Sweringen Company Case.
1. Purchase was by the Coach Company a stockholder; was not by a fiduciary	1. Purchase was by Directors of Debtor, through Midamerica; they were fiduciaries
2. Coach Company did not control Debtor's Board of Directors or its acts	2. Van Sweringens in absolute and complete control of Debtor, its Board of Directors and its acts
3. Court found failure to buy was not due to interference or control by the Coach Company	3. Court found failure to buy was due to interference and control of the Van Sweringens
4. Debtor not found to be insolvent at the date of purchase	4. Court found Debtor was insolvent on the date of purchase
5. Price paid was substantial, approximately $1,100,000.00, 1/10 of face value	5. Price paid was nominal, only $1.00, equal to 1/8177023 of face value
6. Court found Debtor was not financially able to make the purchase	6. Court found Debtor had funds sufficient and available to make the purchase
7. Debtor was not trying to compromise its outstanding debts	7. Debtor was actively working to refund its bonds and mortgages and reduce its obligations
8. Purchase was at sales in open market	8. Purchase was at a sale the Van Sweringens helped to arrange. Public was given very short notice; creditors of the Debtor had no notice

It is respectfully submitted that because the cases are dissimilar in all important respects, and because any similarity is only in their superficial aspects, the decisions are not in conflict.

Petitioner argues that the cases are conflicting decisions on a question of frequent occurrence and considerable significance in the administration and interpretation of the Bankruptcy Act. It has been demonstrated above that the conflict is nonexistent. It is equally apparent that the case at Bar and the *New York Railways Corporation* case do not involve questions in the administration or interpretation of the Bankruptcy Act. True, both cases arose in reorganization proceedings under the Bankruptcy Act; however, that is only incidental and accidental. The questions involved in both cases categorically are not questions of interpretation of the Bankruptcy Act, and just because the questions arise in the determination of the validity of a claim presented against a corporation in reorganization bankruptcy, certainly is not reason for the assertion that the questions are of the administration of the Bankruptcy Act.

Because bankruptcy in fact precipitates the decision of many legal problems, it so happens that bankruptcy brings to light many cases of breach of fiduciary duty by officers and Directors of corporations, and Federal courts have had to decide as courts of equity whether or not fiduciary duties have been breached. The Federal courts, in *Pepper v. Litton,* 308 U. S. 295, 1939; *Magruder vs. Drury,* 235 U. S. 106, 1914, and numerous other cases, without exception have held fiduciaries to a duty of loyalty to their trusts. They have inveighed against overreaching and double dealing. They have taken a stand against the fiduciary profiting through a breach of his duty. *Canton Rolling Machine Co. vs. Rolling Mill Co.,* 168 Fed. 465, C. C. A. 4, 1909. The decisions of the Federal courts, District Courts, Circuit Courts of Appeals and the Supreme Court on these questions are entirely in accord with the decisions of the State courts.

II. MIDAMERICA'S ARGUMENT THAT THE DECISION BELOW IS IN CONFLICT WITH THE STATE LAW.

The second portion of Midamerica's brief in making the claim that the decision below is in conflict with the State law, presents a refreshing bit of wishful thinking. It solemnly proclaims a conflict, and to support the proclamation cites a New York case not at all in point. *Tiffany vs. Smith,* 124 N. Y. Sup. 85, 1910. It also cites three Federal court cases which, because they are Federal court cases and actually are not in conflict with the decisions below, are not authority for the point sought to be made. Midamerica makes the argument that if State law is to govern, the State law of New York, where the sale took place, or of Ohio, which was the State of the domicile of the debtor, should govern. In the case of *Meinhard vs. Salmon,* 249 N. Y., 458, a leading New York case, the duty of a fiduciary is clearly announced by Judge Cardozo:

> "Many forms of conduct permissible in a workaday world for those acting at arms length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. * * * Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court."

Thomas vs. Matthews, 94 Ohio State 32, says:

> "It is the settled rule of this state that Directors must manage the corporate business with a view solely to the common interest and cannot, directly or indirectly, derive personal profit or advantage from their position which is not shared by all the stockholders."

> "The maxim *uberrima fides* of the civil law applies without limitation or restriction to their relation to the corporate property and corporate business. They occupy a strictly fiduciary relation to the stockholders and are accountable to them on principles governing that relationship."

III. MIDAMERICA CLAIMS THAT THE DECISIONS BELOW FAIL TO FOLLOW APPLICABLE DECISIONS OF THE UNITED STATES SUPREME COURT AND THE CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT ON CERTAIN IMPORTANT QUESTIONS IN THE LAW OF CORPORATE FIDUCIARIES.

The argument made by Midamerica at this point is an argument that the courts have held that a fiduciary is entitled to protect a validly acquired and previously existing interest, and that if such is the case an exception is made to the uniform rule that a fiduciary is forbidden to profit from his dealings with the beneficiary. Midamerica in this portion of its brief cites several cases, all of which were before the District Court and the Circuit Court of Appeals. Midamerica advances the argument that because the Van Sweringens owned 80% of the common stock and claimed a beneficial ownership in 56% of the preferred stock of Vaness and had guaranteed the $16,000,000.00 loan which Vaness procured from Morgan, that they had a valid interest in the notes in question which were owned by Vaness and were pledged to secure the Morgan loan. There has been no dispute whatsoever in this case that at the time of the Morgan sale and for some time prior thereto Vaness was hopelessly and completely insolvent to the extent of almost $50,000,000.00, and there is no dispute and has been no dispute in this case concerning the fact that the guarantee by the Van Sweringens of the Vaness loan was a naked guaranty on which the Van Sweringens paid nothing and on which, according to their own voluntary statement, they could pay nothing. The courts below did not disregard *Twin Lick Oil Company vs. Marbury*, 91 U. S.

587, 1875; *Arn vs. Bradshaw Oil & Gas Company,* 108 Fed. 2nd, 125, 1940, and the other cases cited by Midamerica in the third portion of its brief. The courts below found that this case did not come within the rule of those cases because they could not find any valid preexisting interest in the notes in question which could be protected by the Van Sweringens. The Debtor does not dispute the doctrine that a fiduciary, who has acquired a valid interest in an asset owned by his trust, is entitled to use legal means within the rules of fairness to protect that valid interest; however, such a doctrine cannot be properly asserted in this case because, as the courts below have found, the Van Sweringens did not have any valid interest in the notes of the Debtor through their stock ownership in Vaness, which was insolvent, or through their naked guarantee, on which they neither paid nor could pay anything.

IV. MIDAMERICA ARGUES THAT THE DECISIONS BELOW WERE AN OVERZEALOUS APPLICATION OF THE DOCTRINE OF PEPPER vs. LITTON, 308 U. S. 295, IGNORING PRINCIPLES OF EQUITY DECLARED BY THE SUPREME COURT OF THE UNITED STATES, AND THAT THE DECISIONS BELOW UNDERMINE A DIRECTOR'S DUTY OF LOYALTY.

Midamerica states that the evident purpose of the opinion below is to enforce vigorously a Director's duty of loyalty to his corporation but that the effect of the opinion will be the opposite; that it will tend to have a widespread undesirable influence on corporate directors. It is respectfully submitted that the evident purpose of the courts below in following the doctrine of *Pepper vs. Litton, supra,* can be only a desire on the part of the courts below to hold fiduciaries to those standards of honesty, decency and fairness which *Pepper vs. Litton, supra,* announces. To contend that they will have a wide spread undesirable influence on corporate directors can be ad-

mitted only if it is to be presumed that corporate directors, who are fiduciaries, should be encouraged to obtain every personal advantage at the expense of their trusts, short of clear violations of the criminal laws. If individuals are not willing to be bound in their dealings with corporations to the standards of honesty and fairness uniformly enforced by the Federal and State courts in such cases as *Pepper vs. Litton, supra*; *Meinhard vs. Salmon, supra,* and *Thomas vs. Matthews, supra,* they can refuse to act as fiduciaries.

The case of *Sanford Fork & Tool Company vs. Howe Brown & Company,* 157 U. S. 312, 1895, cited by Midamerica to support its argument, is not in point here, and that it is not in point is clear from the quotations which Midamerica makes from that case. In that case the fiduciaries did not execute a naked guaranty. The fiduciaries quite legally obtained a mortgage on the property in question because of the fact that the fiduciaries obtained money for the Company. As Midamerica's brief aptly states it, the Van Sweringens could have had a second mortgage on the Vaness collateral for their own protection. Vaness was not notoriously insolvent at that time. However, the fact is and the fact remains that the Van Sweringens did not get a second mortgage and did not have a second mortgage. The courts below in the case at Bar found that the Van Sweringens breached their duty; that "bad faith and breach of fiduciary duty were implicit." In the *Sanford Fork* case, *supra,* the courts said—"All this was done in the utmost good faith."

CONCLUSION.

The Respondent respectfully submits that the arguments advanced by Midamerica in support of its petition for a Writ of Certiorari are not sound or valid. The courts below did not err in the respects specified by Midamerica or in any other respects. The courts below, after exercising extreme patience and care in their study of the facts and the law, found that the acquisition of the notes in question by Midamerica was in violation of the fiduciary duties owed by the Van Sweringens to the Debtor and that as a corollary, neither the Van Sweringens nor their creature, Midamerica, could be permitted to realize a profit which they could have obtained only through the breach of their fiduciary duties.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. 613

In the Matter of
THE VAN SWERINGEN CORPORATION,
Debtor.

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY
(Formerly Midamerica Corporation),
Petitioner,

vs.

VAN SWERINGEN CORPORATION, *Debtor,*
and
FREDERICK L. LECKIE and JOSEPH G. FOGG,
Trustees of Van Sweringen Corporation,
Respondents.

(A. B. GOCHENOUR, ET AL., *Interveners.*)

PETITION FOR A WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
For the Sixth Circuit, and
BRIEF IN SUPPORT THEREOF

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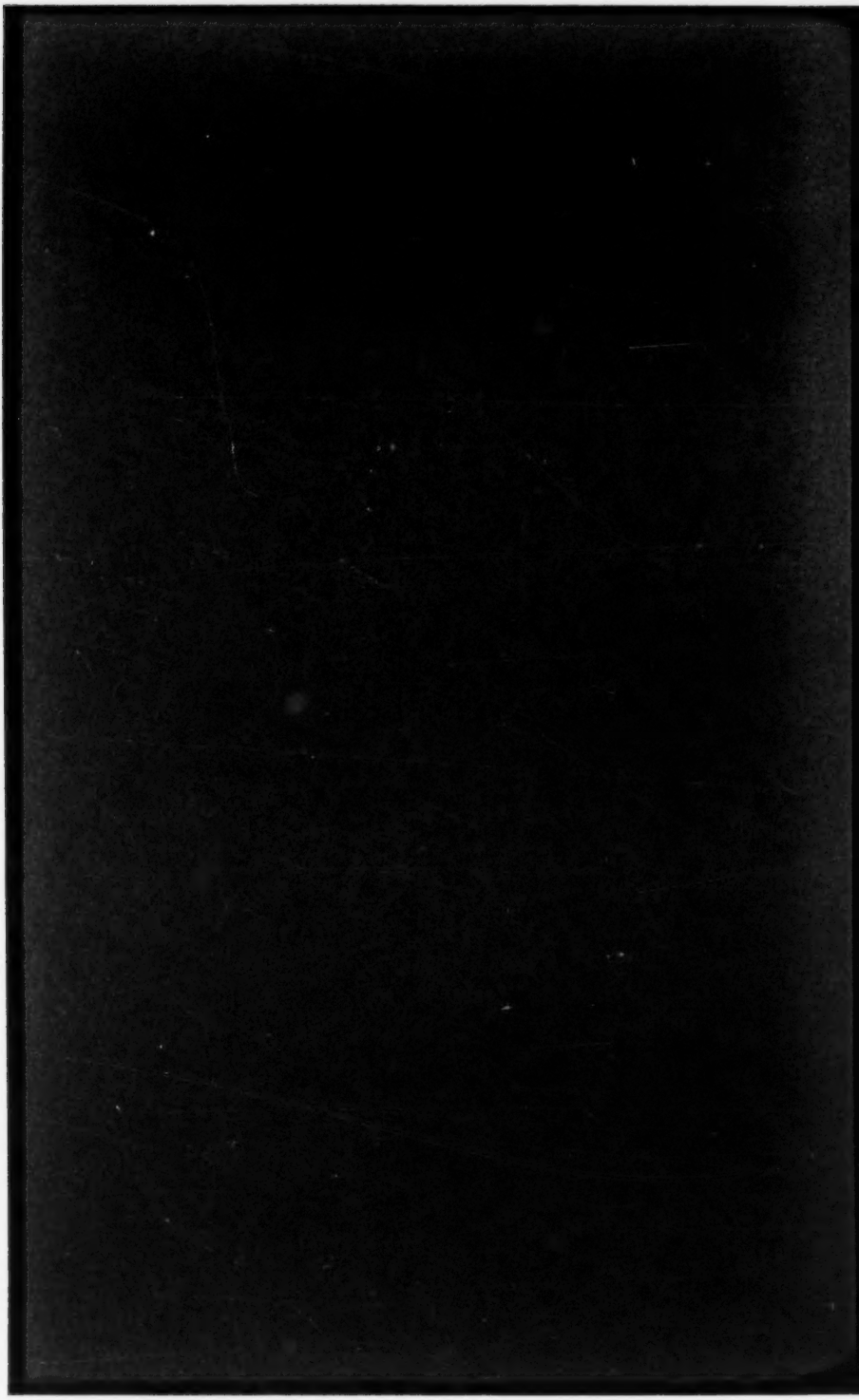

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In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. .....

In the Matter of
VAN SWERINGEN CORPORATION,
Debtor.

THE TERMINAL AND SHAKER HEIGHTS
REALTY COMPANY
(Formerly Midamerica Corporation),
Petitioner,

vs.

VAN SWERINGEN CORPORATION, *Debtor,*
and
FREDERICK L. LECKIE and JOSEPH G. FOGG,
Trustees of Van Sweringen Corporation,
Respondents.

PETITION FOR A WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
For the Sixth Circuit.

The Terminal and Shaker Heights Realty Company (successor by change of name to Midamerica Corporation and hereinafter referred to in this petition and supporting brief as "Midamerica") prays that a writ of certiorari be issued to review an order of the Circuit Court of Appeals for the Sixth Circuit entered in this cause on April 16, 1941. This order affirmed an order of the District Court for the Northern District of Ohio, Eastern Division, disallowing, except for $887, a claim by Midamerica against Van Swer-

ingen Corporation (hereinafter called "the Debtor") in the principal amount of $13,787,000, evidenced by 6% Gold Notes of the Debtor.

Midamerica's petition for a rehearing below was denied on June 25, 1941. (R. 341.)*

OPINION BELOW.

The opinion of the Circuit Court of Appeals for the Sixth Circuit (R. 320-328) is reported in 119 Fed. (2d) 231 (1941).

JURISDICTION.

The jurisdiction of this Court is invoked under Section 24(c) of the Bankruptcy Act (U. S. C. A. Title 11, Section 47(c)) and under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. C. A. Title 28, Section 347).

QUESTIONS PRESENTED.

(1) Did Midamerica acquire good title to the notes of the Debtor which it purchased from J. P. Morgan & Co. at public auction sale on September 30, 1935, as a part of the collateral securing a $16,000,000 loan from J. P. Morgan & Co. to The Vaness Company, or was Midamerica debarred from acquiring good title because O. P. and M. J. Van

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* The Circuit Court of Appeals for the Sixth Circuit by the same decision in 119 Fed. (2d) 231 (1941) dealt with the two companion cases of *Midamerica v. The Van Sweringen Company* and *Midamerica v. The Cleveland Terminals Building Company* and likewise disallowed, except for nominal amounts, claims of Midamerica against The Van Sweringen Company and The Cleveland Terminals Building Company. In the three cases taken together, claims of Midamerica aggregating $21,248,697, for which all three debtor companies admittedly received full value, were allowed for only $890. Midamerica has filed petitions for certiorari in these two related cases which were argued together below and which involve substantially the same questions of fact and law.

All references are to the record below, except for references to the record in *The Cleveland Terminals Building Company* case, which is designated "C. T. B. record."

Sweringen were officers and directors of Midamerica and also officers and directors of the Debtor?

(2) In the reorganization proceedings of the Debtor under Section 77B (now Chapter X of the Bankruptcy Act), should the rule which forbids a director to profit at the expense of his insolvent company by buying up its notes at a discount be applied to a case where the director did not seek and could not make a profit, but only sought to reduce a personal liability resulting from his guarantee of a $16,000,000 loan to The Vaness Company for which the notes of the Debtor were pledged as collateral?

(3) Even if O. P. and M. J. Van Sweringen were personally disqualified from buying the notes of the Debtor, was Midamerica also disqualified despite the fact that it was wholly owned by third parties?*

STATEMENT.

In this case directors who had personally guaranteed $39,500,000 of loans to their companies were denied the right, upon foreclosure of the loans, to purchase part of the pledged collateral in order to protect themselves against liability on their guaranties.

(a) The $39,500,000 Loans of J. P. Morgan & Co. to The Vaness Company and The Cleveland Terminals Building Company.

In October, 1930, The Vaness Company, a holding company of O. P. and M. J. Van Sweringen, and its subsidiary, The Cleveland Terminals Building Company (hereinafter called respectively "Vaness" and "C. T. B." in this peti-

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* For the purpose of presenting the reasons why certiorari should be granted, and only for that purpose, Midamerica assumes that it stands in the shoes of the Van Sweringens, and therefore makes no point at this time of Question (3). Midamerica, however, reserves the right, if certiorari is granted, to contend, as it has contended throughout, that wholly different and additional defenses are available to it from those which would be available to the Van Sweringens themselves.

tion and supporting brief) were in serious need of funds, and O. P. Van Sweringen, on their behalf, entered into negotiations with J. P. Morgan & Co. to secure a loan of $16,000,000 to Vaness and $23,500,000 to C. T. B. J. P. Morgan & Co. would not make the requested loans except upon two conditions: (a) that the Van Sweringens personally guarantee payment of both the loans; and (b) that approximately $15,000,000 of debts of Vaness be paid before the loans were made. (R. 176, 178, 179, 203; C. T. B. record, pp. 123-124, 243, 263.)

Both conditions were met. The $15,000,000 of Vaness debts were cancelled in consideration of their assumption by the Van Sweringens personally, who thereby made a contribution to the surplus of Vaness of nearly $15,000,000 (R. 153-155, 176), and the Van Sweringens personally guaranteed the two loans aggregating $39,500,000, which were made on October 31, 1930. (R. 149; C. T. B. record, pp. 123-124, 243, 263.)

The Vaness loan was secured by the pledge of virtually all the securities belonging to Vaness, among which were the $13,787,000 principal amount of 6% Gold Notes of the Debtor, 71% of whose common stock (the only class outstanding) was owned by Vaness. (R. 27, 24-25.) These notes were originally issued for full value by the Debtor (R. 25), and their enforceability in full in the hands of Vaness has never been questioned.

After 1930, economic conditions became worse.* Vaness and C. T. B. were unable to pay the interest on their loans and, with the consent of the Van Sweringens as guarantors, secured an extension of time for the payment of interest and gave interest notes, also guaranteed by the Van Sweringens. (R. 155; C. T. B. record, pp. 126, 142, 191.) From August, 1934, to the maturity of the loans on May 1, 1935, O. P. and M. J. Van Sweringen made repeated but unsuc-

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* This Court may take judicial notice of this trend, *Great Northern Ry. Co. v. Weeks*, 297 U. S. 135 at 149.

cessful efforts to refund or extend them (R. 156-158; C. T. B. record, pp. 124, 144-145, 243, 263), and at maturity Vaness, C. T. B. and the Van Sweringens admitted their inability to pay them. (R. 181-182; C. T. B. record, p. 168.)

On September 13, 1935, J. P. Morgan & Co. published a notice of the sale of the collateral securing the Vaness and C. T. B. loans, to be held September 30, 1935. (R. 58-66; C. T. B. record, pp. 52-59.)

The notice of sale divided all the collateral to be sold into 58 parcels comprising four groups. The Debtor's notes were Parcel 24, included in Group 1. The parcels were first to be offered for sale separately and then in groups, and if the group bid exceeded the aggregate of the parcel bids, all the parcels were to be sold as a group. (R. 61-63.) Any bidder desiring to qualify was required to deposit, in cash or by certified check, by 11 o'clock on the day of the sale, the various amounts specified in the notice of sale. The amount required to qualify to bid on Parcel 24 was $250, but the amount required to bid on Group 1 was $270,000. (R. 64.)

Groups 1 and 3 comprised securities of the companies which were being managed by the Van Sweringens. (R. 191.) The sale was to be conducted by Adrian H. Muller & Son, well known securities auctioneers of New York, and was widely advertised for two weeks in newspapers of general circulation in New York City and so was widely publicized. (R. 27, 158.) This was in accord with the stated purpose of J. P. Morgan & Co. "to give the widest notice to all possible bidders." (C. T. B. record, p. 176.)

At the time of the auction sale the Debtor was hopelessly insolvent. It had cash on hand of $13.67. (R. 97.) Its liabilities exceeded $21,000,000, and its only assets were the stock of, and a large unsecured claim against, C. T. B. which was likewise insolvent. (R. 97-99.) In October, 1936, just a year after the sale, the Debtor—along with its sub-

sidiary C. T. B.—was forced to initiate proceedings for reorganization under Section 77B of the Bankruptcy Act which are still pending. (R. 2.)

(b) The Formation of Midamerica Corporation and the Purchase at the Morgan Auction.

Midamerica was formed on September 28, 1935, for the purpose of bidding at the Morgan public auction sale for the securities of those companies which were being managed by the Van Swerin[illegible]ns. (R. 28, 66-68.) All the capital stock of Midamerica was subscribed for and purchased by George A. Ball of Muncie, Indiana, and G. A. Tomlinson of Cleveland, Ohio, at a cost of $2,015,000, being 20,000 shares of preferred stock at $100 per share, and 15,000 shares of common stock at $1.00 per share. (R. 29, 67.) Ball and Tomlinson were willing to invest their money only upon the assurance of continued Van Sweringen management (R. 66-68); and to this end they granted to O. P. and M. J. Van Sweringen a ten-year non-assignable option to purchase at cost 55% of the common stock of Midamerica at any time when the Van Sweringens could satisfy five of the six directors of Midamerica that they had "paid or adjusted any and all claims" against them based upon existing or future "commitments or relationships." (R. 67.)

The original directors of the corporation, chosen by Ball and Tomlinson as the sole stockholders, were George A. Ball, G. A. Tomlinson, F. B. Bernard of Muncie, Indiana (a close business associate of Ball who had had no previous connection with the Van Sweringens), O. P. and M. J. Van Sweringen, and Charles L. Bradley (a close business associate of the Van Sweringens). (R. 29.)

Even if the Van Sweringens had voted the optioned shares, which they never did (R. 151-152), they could not have elected a majority of the board of directors because of the provision in the articles of the corporation for cumulative voting, which limited to three the number of direc-

tors which 55% of the common stock could elect. Six directors were provided for and restrictions in the corporate articles and regulations required the vote of five out of these six for (1) enlarging the board, (2) merger, consolidation, or sale of substantially all the corporation's assets, (3) issuance of any new shares, and (4) initiation of any amendments to the corporation's articles or regulations. (R. 68-73.) Thus, although the Van Sweringens were the chief executive officers, they did not—and could not—control the board.

O. P. Van Sweringen was elected president and M. J. Van Sweringen vice-president. Other members of the Van Sweringen administrative organization were elected to the other offices. (R. 29.)

On September 30, 1935, at a meeting of the board of directors attended by all the directors except Bradley, it was resolved that the corporation should qualify as a bidder for Group 1 (embracing Vaness collateral) and for Group 3 (embracing C. T. B. collateral) to be sold at the Morgan sale and that the president or his nominee be authorized to bid for all or any part of the securities in Group 1 and Group 3. (R. 76.) The sale was held on the same day. (R. 31.)

After the securities were offered by parcels, Midamerica made a group bid on the securities in Group 1 and Group 3 which was in excess of the aggregate bids on individual parcels, and all the parcels in these groups were, therefore, sold to it. The purchase price for Group 1 was $2,803,000 (R. 31), and the purchase price for Group 3 was $318,000. (R. 30.) The aggregates of the parcel bids for the respective groups were $2,802,102 and $317,127. (R. 108-110.) Included in Group 1 were the notes on which the claim against the Debtor is founded. Also purchased were common stock of the Debtor, stock and notes of the Van Sweringen Company, large amounts of stock of Alle-

ghany Corporation (a railroad holding company theretofore controlled by Vaness), and numerous other securities of Van Sweringen enterprises. (R. 58-61.) A list of all the 28 parcels comprising Group 1 appears in Appendix A of petitioner's supporting brief.

For purposes of accounting, it was necessary for Midamerica to establish a cost basis for the securities purchased. Accordingly, on October 31, 1935, J. J. Anzalone, treasurer of Midamerica, requested from the auctioneer a list of the individual bids at the auction. On the basis of this he established a book cost of the various parcels. For those parcels on which there were individual bids he took the individual bids. For those parcels on which there was no individual bid he arbitrarily used the sum of $1.00. However, since the bulk bid exceeded the parcel bids, this left an excess of $887, which was arbitrarily assigned to the notes of the Debtor. (R. 31-32.)

Inherent in "participation in the management and direction" of Midamerica by the Van Sweringens was the payment to them of a reasonable compensation. The compensation took the form of a drawing account which amounted to $100,000 per year for their joint services. (R. 271.)

Both O. P. and M. J. Van Sweringen were dead before the end of 1936. Each was liable upon indebtedness aggregating more than $50,000,000 (created mainly by their guaranties of the obligations of Vaness and C. T. B.) and each had relatively negligible assets. They died without paying or adjusting any of their debts existing at the time of the formation of Midamerica, and the option died with them. (R. 33, 166, 167, 67.)

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals for the Sixth Circuit erred—

(1) In holding that Midamerica's claim of $13,787,000 against the Debtor should be disallowed except to the extent of $887 and in affirming the order of the District Court to that effect;

(2) In holding that the guaranty by O. P. and M. J. Van Sweringen of J. P. Morgan & Co.'s $16,000,000 loan to Vaness had no bearing upon the right of the Van Sweringens to protect themselves against loss and continuing liability through the acquisition of an interest in the Debtor's notes as a portion of the collateral which secured the Vaness loan;

(3) In failing to apply the doctrine of *Twin-Lick Oil Company v. Marbury,* 91 U. S. 587 and *Sanford Fork & Tool Company v. Howe, Brown & Company,* 157 U. S. 312, holding that a director has the right to protect legitimately acquired interests;

(4) In finding that the Van Sweringens realized a profit from Midamerica;

(5) In completely disregarding the corporate entity of Midamerica and treating it as a creature of the Van Sweringens;

(6) In finding bad faith on the part of the Van Sweringens.

REASONS FOR GRANTING THE WRIT.

1. The Decision Below is in Conflict with a Decision of the Circuit Court of Appeals for the Second Circuit on a Matter of Importance in the Administration of the Bankruptcy Act.
2. If the Conflict With the Circuit Court of Appeals for the Second Circuit Relates to a Question Which is Controlled by State Law, the Decision Below is Probably Untenable and is in Conflict With the State Law.

3. **The Decision Below Conflicts With Applicable Decisions of this Court and of the Circuit Court of Appeals for the Fifth Circuit on an Important Question in the Law of Corporate Fiduciaries.**
4. **The Decision Below, by an Overzealous Application of *Pepper v. Litton*, 308 U. S. 295, Ignores Well-Settled Principles of Equity as Declared by This Court and, in Fact, Undermines a Director's Duty of Loyalty.**

Petitioner's brief in support of this petition is annexed hereto.

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In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. . . . . .

In the Matter of
VAN SWERINGEN CORPORATION,
Debtor.

THE TERMINAL AND SHAKER HEIGHTS
REALTY COMPANY
(formerly Midamerica Corporation),
Petitioner,

vs.

VAN SWERINGEN CORPORATION, *Debtor,*
and
FREDERICK L. LECKIE and JOSEPH G. FOGG,
Trustees of Van Sweringen Corporation,
Respondents.

BRIEF OF PETITIONER
In Support of Petition for a Writ of Certiorari.

In support of its petition for a writ of certiorari in this case, Midamerica files herein its brief and relies upon the reasons listed in its petition as more fully set forth below.

REASONS FOR GRANTING THE WRIT.

1. The Decision Below is in Conflict with a Decision of the Circuit Court of Appeals for the Second Circuit on a Matter of Importance in the Administration of the Bankruptcy Act.

In *In re New York Railways Corporation*, 82 Fed. (2d) 739 (C. C. A. 2, 1936) cert. den. under the name of *Brukenfeld et al. v. New York Railways Corporation et al.*, 298

U. S. 687 (1936) the question was the enforceability in full by the Fifth Avenue Coach Company of bonds of its subsidiary-debtor, the New York Railways Corporation, then in reorganization under Section 77B. Holding 100% of the common stock and having exclusive voting rights, the parent was a fiduciary. *Southern Pacific Co. v. Bogert*, 250 U. S. 483, 492 (1919). The parent, prior to the 77B proceedings, had purchased $11,000,000, or 54%, of its subsidiary's income bonds at 10% of their face value, and objection was made to the allowance of the parent's claim on these bonds for more than their cost to it. The court held that, because a majority of the debtor's board were "independent" and owed no "allegiance" to the parent, the debtor's failure to acquire its bonds for itself was not owing to improper influence. The parent had not "actively prevented" the purchase of these bonds by the debtor, and hence the court said:

> "The failure of the debtor to so act was undoubtedly due to its financial inability rather than to any other fiduciary faithlessness." (p. 741 of 82 Fed. (2d)).

Here, as in the *New York Railways* case, the failure of the Debtor to acquire its notes was undoubtedly due to its financial inability rather than to fiduciary faithlessness. This is so for two reasons:

(a) Midamerica did not buy the Debtor's notes for $887. Midamerica bought 28 parcels of securities in Group 1 for $2,803,000, by a group bid. (R. 31.) In Appendix A hereof appears a tabulation of these 28 parcels as listed in J. P. Morgan & Co.'s notice of sale. On the day of the sale no consideration was, or had been, allocated to the Debtor's notes or to the other twelve parcels within Group 1 for which no individual bids were made. Midamerica's subsequent allocation—for accounting purposes—of $1.00 to each of these parcels (except for the arbitrary allocation of $887 to the Debtor's notes) does not establish that

Midamerica could have bought, or did buy, these parcels individually for $1.00 or the Debtor's notes for $887.

(b) Even if Midamerica's group purchase is interpreted as meaning that Midamerica purchased the Debtor's notes for $887, neither the record nor sound business judgment warrants the inference that J. P. Morgan & Co. would have sold the Debtor's notes as a separate parcel for $887, or, if so, that such a sale would have been made to this Debtor. The qualifying deposit for parcel 24 was $250. The public auction itself was conducted at arms' length, and the Court below, in related litigation involving the validity of J. P. Morgan & Co.'s loan to C. T. B., *Gochenour v. J. P. Morgan & Co.*, 111 Fed. (2d) 378 (C. C. A. 6, 1940), found the sale to be fair and free from collusion. Nor is there evidence to justify the belief that any antecedent plan by the Debtor in advance of the auction to retire $13,787,000 of valid indebtedness by bidding a nominal sum would have been reasonable or practicable.

Yet the Debtor has consistently argued—and the two lower courts apparently believed—(i) that because this insolvent Debtor had $13.67 in cash available and a large unsecured claim against its utterly insolvent subsidiary, C. T. B., therefore, it could have acquired $13,787,000 of its notes by bidding $887, and (ii) that the Van Sweringens were guilty of gross dereliction in not foreseeing and acting upon this possibility on the Debtor's behalf. It is respectfully urged that this argument ignores realities.

The truth is that here as in *In re New York Railways Corporation, supra,* the failure of the Debtor to act was undoubtedly due to its financial inability and not to prevention by the Van Sweringens or anyone else of a plan by the Debtor to purchase for itself.

It may be contended that the cases are distinguishable in one respect: i.e., the Van Sweringens undoubtedly controlled the Debtor, whereas the court said in the *New York*

Railways case that the board of the subsidiary company was independent and that there was no ground to infer from its inaction any improper influence by the parent.* This distinction is more apparent than real.

As appears from the opinion, the "independence" of the New York Railway board consisted of the fact (see p. 741 of 82 Fed. (2)) that after a period of admitted domination through interlocking directors, the board was reshuffled shortly before the parent's buying program began—so that thereafter only a minority of the board was interlocking. But it is plain from the course of events that in every practical sense, the parent, with 100% voting rights, controlled its subsidiary.**

Thus the parent's plan for acquisition of the bonds was wholly inconsistent with their acquisition by the subsidiary. The parent knew that its stock investment in the subsidiary was of doubtful value, that reorganization was imminent, and that its continued control was threatened unless it could acquire a majority of the subsidiary's income bonds (p. 741, *ibid*). Yet the court held that its action was entirely proper.

It follows, therefore, that in the Second Circuit a dominant stockholder, who is unquestionably a fiduciary, but who sees its investment and control threatened, may purchase at a discount a majority of its subsidiary-debtor's bonds of a given issue and may thus protect its position

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* *In re New York Railways Corporation* was distinguished by the District Court below on this ground. (R. 271.)

** The identical board, as reconstituted in April, was retained in office by the parent at its annual meeting one month later, and the same board continued in office thereafter for two more years. See Petition for Certiorari, page 12, in the United States Supreme Court, October term 1935, No. 1050, filed by Carl Brukenfeld, Louis Krones and Philip Kerby, as a preferred stockholders committee; see also record in that case 1234, 1236, 1251, 1375, and 1236.

by enforcing the bonds in full in subsequent 77B proceedings; provided only that the debtor itself lacks funds for such purchase and that the fiduciary does not "actively prevent" the debtor's purchase on its own behalf. In the Sixth Circuit, on the other hand, dominant directors, under strikingly similar circumstances, must hold what they buy in constructive trust for the debtor.

Nor does this divergence between the two circuits concern a question of infrequent occurrence or slight significance in the administration and interpretation of the Bankruptcy Act.

(i) In no less than eleven cases* arising under former Section 77B or present Chapter X of the Bankruptcy Act, the enforceability of a claim has been attacked on the ground that the acquisition of such claim involved a violation of fiduciary duty or kindred inequitable conduct.

These cases do not present fraud, as in *Pepper v. Litton*, 308 U. S. 295 (1939), nor direct dealings by an officer or director with his company as in *Pepper v. Litton*. They are concerned with purchases of claims against the debtor company by officers or directors who acquire such claims from third persons.

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* *In re McCrory Stores Corporation*, 12 Fed. Supp. 267 (1935); *In re New York Railways Corporation*, 82 Fed. (2d) 739 (C. C. A. 2), cert. den. 298 U. S. 687 (1936); *In re Celotex Co.*, 12 Fed. Supp. 1 (1935); *Security-First National Bank of Los Angeles, et al. v. Rindge Land & Navigation Company, et al.*, 85 Fed. (2d) 557 (C. C. A. 9, 1936); *In re McEwen's Laundry Inc.*, 90 Fed. (2d) 872 (C. C. A. 6, 1937); *In re Radio-Keith-Orpheum Corp.*, 106 Fed. (2d) 22 (C. C. A. 2, 1939); *In re Utilities Power & Light Corp.*, 29 Fed. Supp. 763 (1939); *In re Norcor Manufacturing Company*, 109 Fed. (2d) 407 (C. C. A. 7), cert. den. 310 U. S. 625 (1940); *The Terminal and Shaker Heights Realty Company v. The Van Sweringen Company, The Terminal and Shaker Heights Realty Company v. The Van Sweringen Corporation, The Terminal and Shaker Heights Realty Company v. The Cleveland Terminals Building Company*, all reported in 119 Fed. (2d) 231 (C. C. A. 6, 1941).

Except for claims of landlords, in respect of which this Court has now laid down definitive rules,* the claims of fiduciaries, as shown by the history of Section 77B and Chapter X proceedings, have caused most confusion and uncertainty. Moreover, since investment by corporate officers and directors in the securities of their companies is a widespread and generally understood business practice, the lower federal courts will be increasingly confronted with litigation until definitive rules in this field also have been prescribed by this Court.

(ii) In several of these so-called "fiduciary" cases the lower courts have correctly felt called upon to determine the proper interpretation, scope and effect of two sections of the Bankruptcy Act closely related to the question in this case. Section 202 (U. S. C. A. Title 11, Section 602) provides in material part that the court shall scrutinize the circumstances of an assignment of a future rent claim and the amount of the consideration paid for such assignment in determining the amount of damages allowed the assignee thereof. Section 212 (U. S. C. A. Title 11, Section 612) provides in material part that, in the case of any agent or committee purporting to represent creditors or stockholders, the court may limit any claims or stock acquired by such agent or committee in contemplation or in the course of a proceeding under Chapter X to the actual consideration paid therefor.

One or the other of these sections (set forth in Appendix B hereof) or their predecessors in Section 77B were the subject of careful consideration in four of the cases above noted, i.e., *In re McCrory Stores Corporation, In re*

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* *Kuehner, et al., Trustees, v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 445 (1937); *City Bank Farmers Trust Co., Assignee v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 433 (1937); *Meadows v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 464 (1937); *Schwartz, et al. v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 456 (1937).

McEwen's Laundry, Inc., Security-First National Bank of Los Angeles, et al. v. Rindge Land & Navigation Co., and *In re Celotex Co.*, all *supra*.

The reason for this is plain: Section 212 is a legislative declaration that where claims or stock are acquired by an agent or committee in a representative capacity under circumstances which may involve breach of fiduciary duty, the claimant shall not enforce the claim or stock for more than its cost to him. Section 202 relates to assignment of landlords' claims under circumstances which, as a practical matter, are apt to involve a breach of fiduciary duty. See *In re McCrory Stores Corporation, supra*, the earliest and most frequently cited case in this field.

Consequently, the interpretation and correct application of these two specific provisions of the Bankruptcy Act will in all probability be influenced by the decision of this case.

(iii) It follows from (i) and (ii) above that the present question—although it probes deeply into the law of corporate fiduciaries—is not merely a question of state or local law. Midamerica recognizes that under the decision in *Ruhlin v. New York Life Insurance Co.*, 304 U. S. 202 (1938), conflict among the circuits on the same matter "is not of itself a reason for granting a writ of certiorari" (p. 206, *ibid*) because, since *Erie Railroad Co. v. Tompkins*, 304 U. S. 64 (1938), such conflict "may be merely corollary to a permissible difference of opinion in the state courts." (p. 206 of 304 U. S.)

In the present instance, however, the conflict does not concern a purely local matter like the construction of an insurance contract as in the *Ruhlin* case, *supra*, but on the contrary strikes to the heart of the administration of a national law. The purpose and effect of the Federal reorganization statutes in supplanting equity receiverships is familiar history, *Continental Illinois National Bank &*

Trust Co. v. Chicago, R. I. & P. Ry. Co. et al., 294 U. S. 648, 672 (1935); and the result is that the Federal courts, sitting in bankruptcy and reorganization proceedings, are the forum in which the validity of discount purchases of claims by corporate officers and directors is today tested with the greatest frequency. The volume of litigation in the Federal courts on the subject of discount purchases by fiduciaries has previously been noted (p. 15, *supra*). In two specific sections of the Bankruptcy Act, Sections 212 and 202, dealing with analogous situations, Congress has itself legislated on this subject. Thus, for example, if the present case had been one arising under Section 212 and the Debtor, by favor of that specific section, had set up precisely the same defense as here, the "construction and validity" of a provision of the Bankruptcy Act would in all probability have been squarely involved.*

The Federal Constitution (Article 1, § 8, Cl. 4) vests Congress with the power "to establish * * * uniform Laws on the subject of Bankruptcies throughout the United States." This Court, in varying factual situations, has expressly recognized the desirability of adhering to a policy of uniformity so far as possible. In *Kreitlein v. Ferger*, 238 U. S. 21 (1915) the Court (in considering an objection to a sufficient listing of a creditor's name) said:

> "* * * This objection is more difficult of solution than any of the others presented by this record. But, like them, it must be considered in the light of the fact that the statute was intended for business men and should receive not only a practical but a uniform construction. Its provisions are applicable to creditors who live in the country, in villages, in towns and cities. * * * " (p. 30 of 238 U. S.)

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* (Cf. the group of decisions of this Court cited in the footnote on p. 16, involving the "construction and validity" of the sections dealing with landlords' claims.)

Cf. *Local Loan Co. v. Hunt,* 292 U. S. 234, at page 245 (1934).

This view has been echoed in the lower federal courts. In *In re Bockhaus,* 177 Fed. 141, C. C. A. 7 (1910), the court, pointing out that the Bankruptcy Act is "a national act" and was intended to eliminate as far as possible "the confusion and harassment attendant upon a multiplicity of variant local laws" used the following language:

> "* * * Therefore the act in all its parts ought to be interpreted in a national view, doing away as far as possible with the variances of the local laws. * * *" (p. 145, *ibid.*)

Midamerica submits that the foregoing interpretation of the act is sound and not in derogation of *Erie Railroad Co. v. Tompkins* and that the concept of state law under the doctrine of *Erie Railroad Co. v. Tompkins* should not be expanded in doubtful cases in such a way as to produce unnecessary confusion in the administration of a national act.

Midamerica points out, moreover, that such confusion, produced by the absence of clear principles of guidance, may frequently have the result in the various circuits—as was the fact here—of seriously delaying corporate reorganizations. Such a result is contrary to the intent of Congress that reorganizations be facilitated as much as possible. *Continental Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co. et al., supra,* at p. 685. Midamerica, therefore, urges that certiorari should here be granted to secure uniformity of decision in a field where uniformity is clearly desirable. *Magnum Import Co. v. Coty,* 262 U. S. 159 (1923).

2. If the Conflict with the Circuit Court of Appeals for the Second Circuit Relates to a Question Which is Controlled by State Law, the Decision Below is Probably Untenable and is in Conflict with the State Law.

If, despite the considerations outlined under subsections (i), (ii) and (iii) above, this Court should conclude that the conflict relates to a question controlled by state law, Midamerica submits, in the alternative, that certiorari should be granted because the decision below is "probably untenable" and "probably in conflict with the state law." (See language of Mr. Justice Reed at p. 206 of *Ruhlin v. New York Life Insurance Co., supra.*)

On the assumption that state law governs, it is clear that, under settled principles of the conflict of laws, the applicable law is either that of New York or of Delaware. New York is the state where the Morgan auction sale was held and where the Van Sweringens acted, or failed to act, in such a way as allegedly to involve themselves in a breach of fiduciary duty to the Debtor. See *Beale, The Conflict of Laws,* Vol. Two, §§ 377.2, 378.1 *et seq.* Delaware is the state of the Debtor's incorporation. See *Rogers v. Guaranty Trust Company of New York,* 288 U. S. 123 (1933).

If the law of New York governs, the decision below was in conflict with that law as announced in *Tiffany v. Smith,* 124 N. Y. Sup. 85 (1910), being the only New York case on the subject. In *Tiffany v. Smith,* which was strongly relied on by petitioner below, directors who had guaranteed the obligations of their company were permitted to protect themselves upon a judicial sale of the company's property by buying in the property for themselves, even though they had not discharged their guaranty.

If the law of Delaware governs, we are remitted to the entire body of substantive law on the question, for there is no relevant Delaware authority. There are, of course, general statements in Delaware cases regarding the duty of a director to his corporation (e.g. *Cahall v. Burbage,*

13 Del. Ch. 299, 119 A. 574 (1922)), but opposing counsel have not cited—and petitioner has been unable to find—any Delaware case in point on the issue here involved. Midamerica believes, however, that the decision below was probably in conflict with the Delaware law "as yet unannounced by the highest court of the state" (p. 206 of *Ruhlin v. New York Life Insurance Co., supra*), because that decision was so clearly opposed to the weight of authority.

Relevant decisions of this Court and of the lower federal courts plainly establish the right of a director to protect legitimately acquired interests and to avoid the personal loss and individual liability which would result from the denial of such right in cases where the director has advanced cash or lent credit to his company. These decisions are *Twin-Lick Oil Co. v. Marbury,* 91 U. S. 587 (1875); *Sanford Fork & Tool Co. v. Howe, Brown & Co.,* 157 U. S. 312 (1895); and *Arn v. Bradshaw Oil & Gas Co.,* 108 Fed. (2d) 125 (1940), all of which are analyzed fully under Reasons 3 and 4 below and which, therefore, in the interest of brevity are not discussed at length at this point.

3. The Decision Below Fails to Follow Applicable Decisions of this Court and of the Circuit Court of Appeals for the Fifth Circuit on an Important Question in the Law of Corporate Fiduciaries.

In *Twin-Lick Oil Company v. Marbury,* 91 U. S. 587 (1875), a director in good faith lent money to his corporation and took a mortgage on certain of its property to secure the loan. On default, he foreclosed the mortgage and bought in the property himself. This Court held that he was not accountable for profits later derived from this property; and since this decision, it has been settled law that a director of a corporation may in good faith lend money to it and that the debt thereby created and the security given therefor are valid and enforceable in his hands.

The Court started from the premise that the loan itself was proper. It then reasoned as follows: (i) Since the loan was valid, the director could properly take security. (ii) Since he could take the security, he had a right to enforce it. The case thus stands for the obviously fair doctrine that where a director, acting throughout in entire good faith, acquires valid rights against his company, he may take appropriate steps to protect those rights, and his action in so doing is not inconsistent with his duty of loyalty. Midamerica invokes this doctrine here.

Through personally guaranteeing the $16,000,000 Morgan loan to Vaness in 1930, the Van Sweringens in good faith lent their credit to Vaness. Vaness was a parent holding company which owned 71% of the Debtor's stock and which, pursuant to an offer to all known noteholders of the Debtor, had purchased from the public $13,787,000 of the Debtor's notes for approximately $7,000,000 in cash and 275,000 shares of the Debtor's stock. (R. 48-50, 53, 27.) Because of this guaranty, the Van Sweringens not only risked the complete loss of their investment in Vaness (to which they had made a capital contribution of nearly $15,000,000 (R. 153-155, 176) and 80% of whose common stock they owned (R. 24)), but also they pledged their personal resources to the extent of any deficiency which might result on foreclosure of the Morgan loan of $16,000,000 to Vaness.*

From the beginning, therefore, the Van Sweringens as guarantors were profoundly concerned with the aggregate value of all the pledged collateral. Their contingent liability rose and fell as its value fluctuated up and down, and finally became fixed when its value became fixed on the day

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* Vaness had also guaranteed the $23,500,000 Morgan loan to C. T. B., and consequently all the assets of Vaness, as well as all the personal credit of the Van Sweringens, were back of both loans. (C. T. B. record, pp. 124, 243.)

of the public auction on September 30, 1935. The Van Sweringens' economic and equitable interest in the collateral was thus obvious and unquestioned and justified their attempt to minimize probable heavy loss by acquiring some share in it.

Their attempt, of course, failed. The Van Sweringens at the time of the auction were hopelessly insolvent, with relatively small assets and with liabilities (arising mainly from guaranties of debts of their companies) which totalled more than $50,000,000. (R. 166.) M. J. Van Sweringen died within two months, owing $68,000,000. (R. 166-167.) O. P. Van Sweringen died within a year and two months, owing $80,000,000. (R. 167.) They had not, and could not have, exercised the option. But the very hopelessness of their endeavors to save themselves from total ruin shows how plainly the court below disregarded the record in concluding that the Van Sweringens somehow made a profit from Midamerica.

Until the Van Sweringens had discharged their guaranties, they could make no profit from Midamerica and, indeed, they had no reasonable possibility of making such a profit at any time. Certainly they made no profit from their option, which was never exercised because it could only be exercised after the payment or adjustment of all their debts, including their guaranties. Certainly they made no profit from a drawing account which was given as compensation for management of the valuable railroad properties, which has never been attacked as unreasonable, and which would have been precisely the same irrespective of Midamerica's acquisition of the Debtor's notes. Consequently, *Magruder v. Drury*, 235 U. S. 106 (1914), and *Jackson v. Smith*, 254 U. S. 586 (1921), holding that a fiduciary and his associates are liable for profits realized from their dealings with the beneficiary, are irrelevant, and the reliance of the court below on these cases was error.

The court below dismissed the entire foregoing argument in one paragraph, citing an Ohio case which did not even involve a guaranty.

> "From the premise that the *Twin-Lick Oil Company* case, *supra*, establishes the right of a director to protect a validly acquired interest as against his corporation, appellant earnestly insists that it should prevail in these suits. We cannot concur. The mere fact that the Van Sweringens were endorsers and guarantors of heavy obligations of the corporations in which they were directors does not avoid the effect of the doctrine that they should not be permitted, directly or indirectly, to derive from their position personal profit or advantage not shared by all stockholders. See *Thomas v. Matthews*, 94 O. S. 32, 43."

Twin-Lick Oil Company v. Marbury, supra, clearly demonstrates the incorrectness of this view, because the very basis of this decision is that a director who has lent his credit to his company acquires by virtue of that fact important contract and property rights which otherwise he would not possess. *Twin-Lick Oil Company v. Marbury* was cited with approval in *Allen v. Gillette,* 127 U. S. 589 (1888), and in *Starkweather v. Jenner,* 216 U. S. 524 (1910), to sustain the proposition that even an express trustee may purchase trust property at a judicial sale which he has taken no part in procuring and over which he had no control.

Moreover, the Circuit Court of Appeals for the Fifth Circuit in a recent decision relies in part upon the doctrine of *Twin-Lick Oil Company v. Marbury* to sustain a purchase of corporate property against the charge of breach of fiduciary duty. The case is *Arn v. Bradshaw Oil & Gas Co.,* 108 Fed. (2d) 125 (1940), cert. den., 310 U. S. 646. Here a bank holding a first mortgage given by an oil company foreclosed the mortgage and bid in the property at judicial sale. A few days later, by a separate and independent transaction, it resold the property to the Brad-

shaw Company, which had been formed for this purpose by a group of second-lien creditors of the oil company. Bradshaw, who was president of the new company, had been a director of the oil company and had formerly been associated with one of the largest second-lien creditors. Boyd, who owned a stock interest in the new company, had also been a director of the oil company and continued to be associated with another second-lien creditor. Stockholders of the oil company contended that the position of Bradshaw and Boyd resulted in a violation of their fiduciary duty to the oil company.

The court held to the contrary, citing as one of three relevant decisions by this Court, *Twin-Lick Oil Company v. Marbury, supra.** Among the facts emphasized in the opinion are three in which the *Arn* case closely resembles the case at bar: (a) all the directors of the oil company "did their best" for the oil company prior to the sale (p. 127 of 108 Fed. (2d)); (b) none of the directors of the oil company brought about the foreclosure sale or contributed to it (p. 127, *ibid*); (c) the purchase by the second-lien creditors in order "to recover if possible" their debts against the oil company was not an abuse by the directors of their office (p. 128, *ibid*).

Thus *Twin-Lick Oil Company v. Marbury,* as interpreted by later decisions of this Court and by at least one Circuit Court of Appeals, stands for the principle (in no way inconsistent with a director's duty of loyalty to his corporation) that a director may protect validly acquired rights. Unless this principle is to be narrowly confined to the simple case of a cash loan and sternly rejected in the case of a credit loan, it should govern here.

If the Van Sweringens had been financially able to pay the loan to Vaness and so discharge their guaranty, they

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* The other two cases cited are *Michaud v. Girod,* 4 How. 503 (1845) and *Stephen v. Beall,* 22 Wall. 329 (1874).

would have acquired indefeasible rights in the pledged collateral.* In equity the Van Sweringens, because they continued to remain liable on their guaranties, stand in the same position *with respect to this Debtor* (which could not have received any part of such payment) as if they had paid the loan.

As this Court said in the *Twin-Lick Oil Company* case:

> "Defendant was at liberty to bid, subject to those rules of fairness which we have already conceded to belong to his peculiar position; for, if he could not bid, he would have been deprived of the only means which his contract gave him of making his debt out of the security on which he had loaned his money." (pp. 590-591 of 91 U. S.)

So here, to deny the Van Sweringens the right to buy the Debtor's notes at a free, open and public sale would be to deprive them of their only means of reducing their deficiency liability as guarantors and would nullify in large measure the right of a guarantor or surety to look for protection to the collateral pledged by the principal obligor.

4. The Decision Below, by an Overzealous Application of Pepper v. Litton, 308 U. S. 295, Ignores Well-Settled Principles of Equity as Declared by this Court and, in Fact, Undermines a Director's Duty of Loyalty.

Although the evident purpose of the opinion below is to enforce vigorously a director's duty of loyalty to his corporation in accordance with the recent enunciation of this well-settled duty in *Pepper v. Litton, supra,* the effect of the opinion will be precisely the opposite. The decision, if allowed to stand, will tend to have a widespread, undesirable influence on the attitude of corporate directors because of the very extremes to which it goes and because

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* *Leavenworth County Comm'rs v. C. R. I. & P. Ry.*, 134 U. S. 688 (1890); *Sanford Fork & Tool Company v. Howe, Brown & Company*, 157 U. S. 312 (1895); *Fitzgerald and Mallory Construction Co. v. Fitzgerald*, 137 U. S. 98 (1890).

of the changed judicial attitude which it evidences toward directors who have pledged their entire personal resources for their corporation.

In *Sanford Fork & Tool Company v. Howe, Brown & Company,* 157 U. S. 312 (1895)* this Court clearly confirmed the right of a director-guarantor to protect himself against loss upon his guaranty. In that case the Court had under consideration the validity of a mortgage given by a corporation while insolvent, although still a going concern, in order to protect its directors from liability on account of their personal guaranty of the corporation's notes. In the course of its opinion this Court made the following observation, which is especially pertinent to the circumstances under which the Van Sweringens executed the guaranties here involved:

> "* * * The mortgage was not given simply as security for a past indebtedness, but to induce the indorsers to obtain for the corporation a renewal or extension of its obligations, and to make further indorsements. In reliance upon this mortgage the indorsers secured renewals or extensions, or themselves took up the notes they had indorsed, and at the same time lent the credit of their names to new paper of the company. *Thus they prevented a suspension of the business and enabled the corporation to continue its operations, and did so believing that by such continuance the corporation would be enabled to work itself out of its temporary difficulties. All this was done in the utmost good faith.*" (pp. 316, 317 of 157 U. S.)
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> * * * * *
>
> "We are of opinion that these facts clearly and fully distinguish this case from many which have been

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* The *Sanford* case was cited to the court below as one of 16 decisions (collected in the appendix to Midamerica's main brief below) which involved guaranties by a fiduciary and in which the fiduciary's purchase of corporate property or debt was upheld. The *Sanford* case was followed in *Geisenberger & Friedler et al. v. Robert York & Co. et al.,* 262 F. 739 (C. C. A. 5, 1919) and *In re Federal Coal Co.,* 31 F. (2) 375 (1927).

> cited, in which the action of the directors of a corporation in securing to themselves preferences in the hour of its extremities has been adjudged void, *and that it is going too far to hold that a corporation may not give a mortgage to its directors who have lent their credit to it, to induce a continuance of the loan of that credit, and obtain renewals of maturing paper at a time when the corporation, though not in fact possessed of assets equal to its indebtedness, is a going concern, and is intending and expecting to continue in business.* We are, therefore, of opinion that the Circuit Court erred, * * *." (p. 320, *ibid.*) (Emphasis supplied.)

Under this decision the Van Sweringens would have been entitled, for their own protection, to take a second mortgage on the Vaness and C. T. B. assets pledged with Morgan. Under this decision the Van Sweringens, in guaranteeing the loans to Vaness and C. T. B., unquestionably acted in good faith. Yet the court below found that "bad faith and breach of fiduciary duty were implicit" in the purchase by the Van Sweringens of the collateral securing the guaranteed loans and further held that the Van Sweringens were not entitled, as "endorsers and guarantors of heavy obligations" of their corporations, to protect themselves against liability. (R. 179, 185.)

If the opinion below is allowed to stand, directors will know that in the Sixth Circuit their duty of loyalty is a dangerous duty. They will know that they act at their peril in pledging their personal credit on behalf of their companies—however urgent the need and however wise the pledge from a business standpoint. They will know that although previously courts have encouraged a director's willingness to risk his own resources for the sake of the corporate enterprise,* today this outlook no longer pre-

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* As the Court said in *Arn v. Operators Royalty & Producing Co.*, 13 Fed. Supp. 769, 773 (1936), an officer who has made a loan in good faith "* * * should be commended rather than condemned for the action * * *."

vails. They will know finally that all fiduciaries are lumped indiscriminately into one large class; that the right to protect a legitimate interest (which is the underlying theme of *Twin-Lick Oil Co. v. Marbury, Sanford Fork & Tool Company v. Howe, Brown & Company,* and *In re New York Railways Corp.,* all *supra*) is no longer extended to corporate directors; and that a rule which in equity and fairness has previously been applied only to profit-seeking volunteers (having no pre-existing interest to protect) is now applied even to directors who, because of their position as guarantors or sureties, seek simply to reduce overwhelming losses and to minimize enormous liabilities.

CONCLUSION.

It is respectfully submitted that this Court should grant Midamerica's petition for a writ of certiorari in order (a) to resolve a conflict of decision between the Circuit Courts of Appeals of the Second and Sixth Circuits on a matter of importance in the administration of the Bankruptcy Act, or, in the alternative, to resolve a conflict between the decision below and the applicable state law, and (b) to remove the doubt, confusion and uncertainty which have been engendered in the law of corporate fiduciaries through overzealous application by the court below of *Pepper v. Litton* and its failure to follow the equitable principles laid down in *Twin-Lick Oil Co. v. Marbury, Sanford Fork & Tool Company v. Howe, Brown & Company,* and *Arn v. Bradshaw Oil & Gas Co.*

William H. Thompson,
Everett Warner,
Charles S. Wachner,
Counsel for Petitioner.

APPENDIX A.

GROUP 1.

	Security Purchased	Individual Parcel Bid	Market Value[1]
1.	100,000 shares of common stock of Alleghany Corporation	$ 50,000	$ 137,500
2.	"	40,000	137,500
3.	"	30,000	137,500
4.	"	20,000	137,500
5.	"	10,000	137,500
6.	"	12,914	177,556
7.	6,915 shares of preferred stock, Series A, of Alleghany Corporation	28,933	34,011
8.	10,000 shares of the capital stock of Cleveland Railway Company	598,800	640,000
9.	"	598,800	640,000
10.	"	598,000	640,000
11.	10,393 shares of the capital stock of Cleveland Railway Company	622,540	665,152
12.	250 shares of the capital stock of Huron-Fourth Company	1,250	no market value
13.	196 shares of the capital stock of The Long Lake Company	none	no market value
14.	17,000 shares of the capital stock of Terminal Building Company	none	no market value
15.	122,000 shares of the common stock of the Debtor	none	no market value
16.	1,244,580 shares of the common stock of Van Sweringen Corporation	none	no market value
17.	$139,000 certificates of deposit representing bonds of Alleghany Corporation	29,885	31,970
18.	$270,000 second mortgage bonds of The Cleveland Terminals Building Company	none	no market value
19.	$817,460.36 demand notes of The Long Lake Company	25,000	no market value
20.	$278,204.84 demand notes of Metropolitan Utilities, Inc.	none	no market value
21.	$207,176.60 demand notes of Terminal Building Company	none	no market value
22.	$170,430.29 demand note of The Terminal Hotels Company	none	no market value
23.	$6,261,697.59 demand notes of The Van Sweringen Company	none	no market value
24.	*$13,787,000 gold notes of the Debtor*	*none*	*no market value*
25.	$554,103 demand notes of Van Sweringen Corporation	none	no market value
26.	$2,595,398.85 subordinated note of Van Sweringen Corporation	none	no market value
27.	$1,292,534.72 subordinated note of The Higbee Company	83,333	no market value
28.	$69,673.71 participation in $523,043.51 note of The Higbee Company	52,256	no market value

[1] Computed on the basis of the lowest sale price on September 30, 1935, or, if there were no such sale, the bid price on that date on the exchange (New York or Cleveland) on which the security was listed. Petitioner recognizes, of course, that the Alleghany, Cleveland Railway, and Pittston securities could not have been sold in large blocks at the prices indicated.

The market quotations relating to the Alleghany common stock and the Cleveland Railway stock are based on the record. (R. 36.) The quotations relating to the other listed securities are based on "The Commercial & Financial Chronicle" for September, 1935.

APPENDIX B.

11 U. S. C. A. § 602. *Rejection of executory contract or unexpired lease; assignment of future rent claim.*

In case an executory contract shall be rejected pursuant to the provisions of a plan or to the permission of the court given in a proceeding under this chapter, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity in a prior pending proceeding, any person injured by such rejection shall, for the purposes of this chapter and of the plan, its acceptance and confirmation, be deemed a creditor. The claim of the landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be provable, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by such lease for the three years next succeeding the date of the surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid accrued rent, without acceleration, up to such date of surrender or reentry: *Provided,* That the court shall scrutinize the circumstances of an assignment of a future rent claim and the amount of consideration paid for such assignment in determining the amount of damages allowed the assignee thereof. July 1, 1898, c. 541, § 202, as added June 22, 1938, c. 575, § 1, 52 Stat. 893.

11 U. S. C. A. § 612. *Same; regulation by court.*

The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor. July 1, 1898, c. 541, § 212, as added June 22, 1938, c. 575, § 1, 52 Stat. 895.

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In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. 613.

In the Matter of

VAN SWERINGEN CORPORATION,

Debtor.

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY

(Formerly Midamerica Corporation),

Petitioner,

vs.

VAN SWERINGEN CORPORATION, Debtor,

and

FREDERICK L. LECKIE and JOSEPH G. FOGG, Trustees of Van Sweringen Corporation,

Respondents.

(A. B. GOCHENOUR, *et al.*, Intervenors.)

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

The writ of certiorari should not be granted because there is nothing presented except questions of fact which have been decided against Petitioner on five occasions by three lower tribunals.

PROCEDURE BELOW.

The matter was originally heard by a Special Master, upon objection by the Trustees of Van Sweringen Corporation to the claim of Midamerica in the amount of $13,787,000.00. The Master sustained the objections, made findings of fact and allowed the claim in the amount paid there-

for by Midamerica, namely $887.00 (R. 122). Midamerica then obtained leave to introduce additional evidence. (R. 258). After the introduction and consideration of the additional evidence, the Master filed an interim report recommending that the objections of the Trustees be sustained (R. 259). Upon exceptions and objections by Midamerica to the interim report, and after briefing and oral argument, the District Court rendered its opinion approving and adopting the findings and recommendations of the Special Master (R. 269) and made additional findings of fact (R. 278). Upon appeal by Midamerica to the Circuit Court of Appeals for the Sixth Circuit, and after submission of briefs and oral argument, the Circuit Court of Appeals rendered its decree April 16, 1941 affirming the District Court in all respects (R. 319); for opinion of the Circuit Court of Appeals see R. 320, also reported at 119 F. (2d) 231. Upon the petition by Midamerica for rehearing supported by brief, the Circuit Court of Appeals denied a rehearing (R. 341).

THE FINDINGS BELOW.

The three lower tribunals were in accord on these vital points:

1. That O. P. and M. J. Van Sweringen were officers and directors and in control of Van Sweringen Corporation.
2. That the Van Sweringens caused Midamerica Corporation to be formed for the purpose, among other things, of acquiring claims against Van Sweringen Corporation at a tremendous discount.
3. That Midamerica purchased $13,787,000.00 principal amount of notes of Van Sweringen Corporation for the sum of $887.00.
4. That no notice of such proposed purchase was given to creditors or stockholders of Van Sweringen Corporation.
5. That Van Sweringen Corporation was then insolvent, but had the financial ability to buy these notes at the cost to Midamerica.

6. That those in control of Van Sweringen Corporation took no steps to protect its interests or to cause it to acquire the notes.
7. That O. P. and M. J. Van Sweringen stood to derive a personal profit from such purchase.

The District Court specifically found (R. 278-279):

"2. The plan and scheme which culminated in the option agreement of September 21, 1935, and in the formation of Midamerica Corporation, was that of O. P. Van Sweringen and M. J. Van Sweringen. The essentials of such plan had appeared in plans prepared by O. P. Van Sweringen and M. J. Van Sweringen or in their office and under their direction prior to the time when they approached George A. Ball and G. A. Tomlinson, and were neither originated nor dictated by Messrs. Ball and Tomlinson.

* * *

5. O. P. Van Sweringen and M. J. Van Sweringen acquired valuable rights and stood to profit personally by means of the option agreement of September 21, 1935, and their interest in and employment by Midamerica Corporation. The option agreement was a device for placing the interests of O. P. Van Sweringen and M. J. Van Sweringen in the purchased securities and obligations beyond the reach of their creditors.

6. The cost to Midamerica Corporation of the $13,787,000.00 principal amount of notes, to-wit, $887.00, was not a fair consideration for these notes."

The Circuit Court of Appeals in its opinion, after stating that the District Court had allowed this claim in the amount of $887.00, partially summarized the facts as follows (R. 320):

"The District Court found that the foregoing allowances were the amounts shown on the books of Midamerica Corporation as the purchase price of the notes and bonds of the respective debtors acquired by Midamerica at auction sale on September 30, 1935; that Midamerica Corporation was a combination in corporate form, participated in by directors of the respec-

> tive debtor corporations, formed and utilized for the purpose, among other things, of divesting the debtor corporations of their properties or of obtaining claims against them at a sacrifice for the profit of the combination at the expense and to the detriment of the debtor corporations; that the debtor companies were insolvent on the date of the auction sale and could not meet their maturing obligations, their assets at a fair valuation not equaling their liabilities; that bad faith and breach of fiduciary duty were implicit in the purchases by the officers of the Company of the corporate securities for their personal advantage; that the Midamerica Corporation acquired and holds the notes and bonds as trustee for the respective debtor corporations and that appellant, as its successor, is entitled to allowance of its respective claims only for the amounts paid for the same, together with interest thereon. *We find that the record in each of the three cases abundantly supports these findings of the District Court.*" (Emphasis ours.)

The Circuit Court of Appeals further held that the Van Sweringens, as directors of insolvent corporations, in association with outside enterprisers, purchased these claims against their *cestui que trust* "at substantially less than real values" (R. 325).

This Court has repeatedly held that certiorari will not be granted merely to review inferences drawn from the evidence, and that where two lower courts have concurred in deciding questions of fact, such findings will not be disturbed where there is evidence to support them.

> *Texas & New Orleans Railroad v. Brotherhood of Railway Clerks*, 281 U. S. 548;
>
> *General Talking Pictures Corporation v. Western Electric Company*, 304 U. S. 175 at 178;
>
> *Just v. Chambers*, 61 S. Ct. 687, 85 L. Ed. 569, decided March, 1941.

These findings have ample support in the evidence in this case.

THE RECORD SUPPORTS THESE FINDINGS.

O. P. and M. J. Van Sweringen were directors and officers and were in control of Van Sweringen Corporation (R. 24, 25, 37, 279). O. P. and M. J. Van Sweringen were also directors and in control of Vaness, which owned the controlling stock of Van Sweringen Corporation (R. 24, 25, 36).

The notes in question were part of an issue of $30,000,000.00 principal amount, issued in May 1930 by Van Sweringen Corporation, respondent herein. The total issue was purchased by the general public (R. 25). About a year and a half later Van Sweringen Corporation repurchased $15,000,000.00 principal amount of these notes from the general public, paying approximately $500.00 in cash and 20 shares of common stock of Van Sweringen Corporation for each $1,000.00 note. These notes were retired, leaving $15,000,000.00 principal amount outstanding (R. 26). Of these, $1,213,000.00 principal amount still remain in the hands of the public (R. 27), and have been allowed in these proceedings as a valid claim. The remaining $13,787,000.00 principal amount of notes for which Midamerica paid $887.00 are the subject of this proceeding.

The repeated unsuccessful efforts of O. P. and M. J. Van Sweringen (referred to at page 4 of Petitioner's Brief) to refund or extend the Vaness and C. T. B. notes in the amount of $16,000,000.00 and $23,500,000.00 respectively, consisted of attempts to coordinate all of the indebtedness in which they were interested, which included other obligations of their personal holding company (Vaness), their own personal debts and debts of many of their other companies, aggregating $76,000,000.00 worth of indebtedness. These efforts had these principal objectives: (1) to release the Van Sweringens from their guarantees of the Vaness and C. T. B. notes; (2) to cancel certain other personal indebtedness approximating $17,000,000.00; (3) to enable O. P. and M. J. Van Sweringen to retain control of their

various enterprises and (4) to avoid the imposition of large personal income taxes upon the Van Sweringens. (R. 156-158, 186 offered 158 Stip. 18D, 278).* Some 26 drafts of plans were prepared (R. 206).

On the very day the Morgan loans became due, i.e. May 1, 1935, the Van Sweringens wrote J. P. Morgan & Company stating that the loans would not be paid and that a sale of the collateral would be necessary (R. 181 offered 151 Stip. 3). The Van Sweringens then devised numerous plans for the purpose of acquiring that portion of the collateral representing the Van Sweringen enterprises, which was later put in groups 1 and 3 and was finally acquired by Midamerica at auction sale (R. 229 offered 212, 239 offered 219, 240 offered 219, 255 offered 219).

By letter of July 20, 1935 the Van Sweringens personally offered to buy at private sale from J. P. Morgan & Company for $2,275,000.00, through the medium of furnishing a purchaser, the Vaness and C. T. B. notes and approximately that portion of the collateral which was finally purchased by Midamerica (R. 188 offered 158 Stip. 18E). A week or ten days later, but before there was any discussion with Ball or Tomlinson, a plan was prepared in the office of O. P. Van Sweringen, which contains almost the exact language of the option agreement which Ball and Tomlinson finally made with the Van Sweringens (R. 215, 253 offered 219).

In early August, 1935, J. P. Morgan & Company advised the Van Sweringens that the collateral would be sold at public sale (R. 158). Public announcement was made September 13, of the auction to be held September 30, 1935 (R. 159). This was by publication of notices of sale in New York City newspapers; and except for notice to O. P. and M. J. Van Sweringen, was the only notice of the auc-

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* Record references to the paragraphs of the Stipulations where exhibits to Stipulations were introduced are referred to as Stip. .....

tion sale which was given to stockholders or creditors of Van Sweringen Corporation. The notice of sale divided the collateral into four groups along the lines of the previous plans and the Van Sweringen letter of July 20, groups 1 and 3 (which Midamerica purchased at the auction sale) comprising the securities which related to and constituted control of the Van Sweringen enterprises (R. 58, 240 offered 219, 229 offered 212, 188 offered 158 Stip. 18E).

Between the time that J. P. Morgan & Company first advised the Van Sweringens of the public sale and the public notice on September 13, 1935, to-wit: on August 10, 1935, the Van Sweringens contacted George A. Ball (R. 27-28). The result was the option agreement of September 21, 1935 (R. 66 offered 28 Stip. 18), which contained the essential elements of the plans which the Van Sweringens had made prior to their meeting with Ball (R. 186 offered 158 Stip. 18D, 229 offered 212, 239 offered 219, 240 offered 219, 253 offered 219).

Although this option agreement has the form of a letter from Ball and Tomlinson to the Van Sweringens, dated September 21, accepted by the latter on September 30, practically all of its terms had been agreed upon by August 15 and it was drafted by the Van Sweringens' own attorney, who also attended to the incorporation of Midamerica (R. 28, 216).

It provided, among other things, that a corporation should be formed to purchase portions of the collateral to be sold by J. P. Morgan & Company and that Ball and Tomlinson should purchase $2,000,000.00 of preferred and $15,000.00 of common stock of that corporation. The agreement further provided that O. P. and M. J. Van Sweringen were to have the sole and exclusive right to vote 55% of the common stock during a period of ten years and that during such time they were to have an irrevocable option, without the right of assignment, to purchase 55% of the common for $8,250.00, plus interest at 5% per annum

"at any time after you shall have satisfied at least five of the six directors of such corporation that you (in keeping with your expressed desires) have paid or adjusted any and all claims based upon now *existing commitments or relationships that may now or hereafter become enforcible against you." (R. 67.)

Hence, without having to pay one cent down, by this agreement the Van Sweringens (a) secured control of the voting stock for a period of ten years, with the additional right (b) to become the owners of said stock and thereby to share in any profit made upon securities acquired, on payment of the trifling sum of $8,250.00, plus 5% interest, and (c) all through a non-assignable, personal option which their creditors could not touch.

It was also agreed that O. P. and M. J. Van Sweringen should have a drawing account from Midamerica of $100,000.00 per year (R. 143), which sum the Van Sweringens were paid. This agreement likewise followed the earlier plan of O. P. Van Sweringen (R. 186 offered 158 Stip. 18D).

The original Board of Directors was selected by the option agreement of September 21, 1935 (not by Ball and Tomlinson, as alleged in the brief of petitioner), it being specified that three of the six directors should be O. P. Van Sweringen, M. J. Van Sweringen and their associate C. L. Bradley (R. 67 offered 28 Stip. 18). Prior to the auction sale they were so elected directors and were also elected to the principal offices of Midamerica, all of the other offices being filled by members of the Van Sweringens' organization (R. 29).

This Board of Directors of Midamerica authorized O. P. Van Sweringen to attend the auction sale and

"either personally or through such nominee as he may designate to bid for and purchase all or any part of the securities included within said Group 1 and/or said

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* Petitioner's brief at page 6 enlarges this condition to "existing *or future* commitments or relationships."

Group 3 at such price and prices as he may determine." (R. 29, 73 offered 29 Stip. 23).

Following the sale O. P. Van Sweringen reported back to the Board that Midamerica had purchased groups 1 and 3 (R. 77).

The indicated market values of the listed securities only, which Midamerica purchased at the auction sale, were $5,745,219.00 on the day of the sale.*

These securities included control of Alleghany Corporation (R. 165-166). For these listed securities and also for the many unlisted securities of the Van Sweringen interests, including also the notes which are the subject of this claim, Midamerica paid a total of only $3,121,000.00.

Midamerica allocated $887.00 of the purchase price to these notes of Van Sweringen Corporation (R. 108 offered 31 Stip. 28). The meeting of shareholders of Midamerica held May 24, 1938 specifically approved a report which showed that the "cost" of those notes was $887.00 (R. 162). In computing income tax on sales of other securities purchased at the auction sale the cost which Midamerica had similarly allocated to such other securities was used (R. 32).

Petitioner originally denied, but now admits, that Van Sweringen Corporation was insolvent at the time of the auction sale. At the same time C. T. B. was indebted to Van Sweringen Corporation for more than $27,000,000.00, had income which was not subject to pledge and responded to demands made from time to time by Van Sweringen Corporation for partial repayments both before and after the purchase by Midamerica of these securities. The repayments so made by C. T. B. were more than sufficient to enable Van Sweringen Corporation to make the purchase at the price paid by Midamerica (R. 33).

Midamerica purchased and retired all of its preferred stock at par (R. 161).

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* The tabulation in Appendix A of Petitioner's Brief states that items 12-16 and 18-28 of Group 1 had "no market value." This goes entirely outside the record, which contains nothing whatever about the market value of those items.

No common stock of Midamerica was issued and no meeting of shareholders was had until after the death of O. P. and M. J. Van Sweringen (R. 151).

After Midamerica had sold part of the securities acquired at the auction for $2,524,895.00 (R. 32), George A. Ball made a gift to the George and Frances Ball Foundation of 14,050 out of the 15,000 shares of common stock of Midamerica (R. 161). The George and Frances Ball Foundation then sold either this common stock or an equivalent 93-67/100% interest in the assets of Midamerica to Messrs. Young, Kolbe & Kirby for approximately $6,000,000.00 (R. 161, 194 offered 161 Stip. 27).

Although the Van Sweringens guaranteed the Vaness and C. T. B. loans, they never paid anything under those guarantees, nor did they compromise their liabilities thereunder, nor secure any release therefrom (R. 149).

Van Sweringen Corporation, controlled by the Van Sweringens, made no bid at the auction sale on September 30, 1935, and took no corporate action to authorize a bid (R. 165). O. P. and M. J. Van Sweringen never notified the creditors or stockholders of Van Sweringen Corporation that they intended to purchase these notes of Van Sweringen Corporation on behalf of themselves and their associates in Midamerica (R. 159).

At no time after the auction sale did Midamerica offer to Van Sweringen Corporation any opportunity to acquire said $13,787,000.00 principal amount of Van Sweringen Corporation notes (R. 33).

I.

THE COURTS BELOW CORRECTLY APPLIED THE DECISIONS OF THIS COURT.

Petitioner asserts that the courts below were "overzealous" in their application of *Pepper vs. Litton*, 308 U. S. 295. We submit that, in view of the evidence and the findings above set forth, the courts below reached the only possible conclusion and correctly applied both the letter

and the spirit of *Pepper vs. Litton.* The gist of that decision is that a trustee cannot serve two masters; that a fiduciary will not be permitted to profit at the expense of his *cestui que trust,* and that if he puts himself in a position where his self-interest conflicts with his fiduciary duty, his self-interest must give way, even though it means personal loss. This rule is basic and cannot be disregarded by reason of any guarantees or other contracts which the trustee may later make with third persons.

The Van Sweringens were not only officers and directors of Van Sweringen Corporation, and therefore fiduciaries, but were also in control of the corporation; and under the doctrine both of *Pepper vs. Litton* and of *Twin Lick Oil Co. v. Marbury,* 91 U. S. 587, upon which petitioner also relies, their acts are subjected to "more severe scrutiny and their validity determined by more rigid principles of morality, and freedom from motives of selfishness" than if they were not in such control.

Applying these principles to the facts here present, the Van Sweringens must stand condemned. They placed their self-interest in endeavoring to make a profit ahead of their duty to their corporation. It makes no difference that they died before they were able to realize the profit. The attempt to prefer their own interests above those of their *cestuis* was enough. As the Sixth Circuit Court of Appeals said (R. 328):

> "It is apparent here that the cupidity of persons in a fiduciary position has caused them to serve themselves in preference to those whom it was their duty to serve. Such dereliction is forbidden by just principles of law."

In *Twin Lick Oil Co. v. Marbury,* the company was barred by its laches in waiting four years until the energy, skill and money which the purchaser invested in the property had made it profitable. The purchaser was a minority director who had paid a fair price and had acted in good faith throughout the transaction. In the present case there

is no laches chargeable against Van Sweringen Corporation, and as the Sixth Circuit Court of Appeals said (R. 326):

> "The evidence of manifest good faith of a director in dealing with his company revealed in *Twin Lick Oil Co. v. Marbury,* 91 U. S. 587, heavily depended upon by appellant, utterly distinguishes that case from the instant litigation."

In *Sanford Fork & Tool Co. v. Howe, Brown & Co. Ltd.,* 157 U. S. 312, also relied on by petitioner, the court likewise found that everything was done "in the utmost good faith" (page 317 of 157 U. S.). The corporation had given security but there had been no sale of the property, no purchase by the directors at an unconscionable discount and hence no issue before the court on the right to profit. The opinion recognized that directors of an insolvent corporation, who preferred themselves, would be held to account.

II.

THE CLAIMED CONFLICT WITH OTHER CIRCUITS.

A. Petitioner Did Not Rely Upon Those Decisions in the Sixth Circuit Court of Appeals.

Petitioner now claims that certiorari should be granted because of conflict with the decision of the Second Circuit Court of Appeals in re: *New York Railways Corporation,* 82 F. (2d) 739 and with the decision of the Fifth Circuit Court in *Arn v. Bradshaw Oil & Gas Co.,* 108 F. (2d) 125. Both of these cases were reported and available at the time the present case was submitted to the Circuit Court of Appeals for the Sixth Circuit. Yet petitioner did not cite either one of those decisions to the Sixth Circuit Court of Appeals.

At least as far as the *New York Railways* case is concerned this was not because petitioner was unaware of that case. In the District Court petitioner relied heavily upon the *New York Railways* case. But in its briefs and oral

argument in the Circuit Court of Appeals petitioner never once mentioned that case. Obviously petitioner at that time either thought so little of the *New York Railways* case that it omitted the case, or it deliberately withheld the citation from the consideration of the Sixth Circuit Court of Appeals in the hope of obtaining certiorari upon a purported conflict of decisions if defeated; and neither reason was fair to the court below.

An appellant is not entitled to be heard in this Court on questions not presented to the lower court. In *J. M. Robinson & Co. v. Belt,* 187 U. S. 41, the court said:

> "While it is the duty of this court to review the action of subordinate courts, justice to those courts requires that their alleged errors should be called directly to their attention and that their action should not be reversed upon questions which the astuteness of counsel in this court has evolved from the record. It is not the province of this court to retry these cases *de novo.*"

To the same effect:

Helvering v. Minnesota Tea Co., 296 U. S. 378.

By analogy a petitioner should not be heard to say that a decision of the court below is in conflict with an earlier decision of another circuit court of appeals without giving the court below the benefit of that authority and a chance to either follow or distinguish that authority.

B. There Is No Conflict.

Both of the cases upon which petitioner relies recognize the basic duty of a fiduciary, but do not conflict with the present decision because of the entirely different facts which were presented to those courts.

In the *New York Railways* case (1) the parent company did not have a majority on the subsidiary debtor's board of directors and therefore did not have control; (2) the court found that the failure of the debtor to buy

its own bonds was not due to any control or interference by the parent; (3) nowhere does it appear that the debtor was insolvent at the date its bonds were purchased; (4) the debtor was financially unable to buy up its bonds; and (5) the price paid by the purchaser was substantial and there was no unconscionable discount.

The facts in the present case are contrary to those in the *New York Railways* case in all of the above respects. All of them are covered by the findings below. Petitioner argues strenuously that the failure of Van Sweringen Corporation to act was due to its financial inability to purchase and not to the control which the Van Sweringens had. But in this respect it asks this Court to disregard the findings made and concurred in by all of the lower courts and to make a contrary finding of fact. Without such complete disregard of the findings of fact of the lower courts, there is no possible basis for claiming a conflict between the decision of the Sixth Circuit Court in this case, and the decisions of the Second Circuit Court and the Fifth Circuit Court upon which petitioner relies.

In *Arn v. Bradshaw Gas & Oil Company,* a bank, holding a first mortgage on the property of an oil company, foreclosed and, subsequent to the foreclosure, sold the property to a corporation formed by some of the second lien creditors, at an amount equal to the first mortgage. Some of those second lien creditors, to protect their interests, had placed directors upon the board of the old oil company when it first became financially involved. Such creditor directors were a minority of the board and all of them had resigned prior to the sale by the bank to the new corporation. Upon suit brought by shareholders of the old corporation, the court refused to set aside the sale, pointing out that the directors did not bring about the sale; that the creditor directors were in the minority and were not in control of the board; that at the time of the sale the old company was in the hands of a receiver; and that the resale

was started after the foreclosure was completed and was an entirely separate transaction. So far as appears, the price paid at the foreclosure sale was fair and the property was not bought at the tremendous and unconscionable discount that was present in the instant case. In all of these respects the *Arn* case materially differs from the instant case.

Where the asserted conflict is one of fact, it is not a basis for certiorari.

Houston Oil Co. of Texas v. Goodridge, 245 U. S. 440;
Wisconsin Electric Co. v. Dumore Co., 282 U. S. 813.

C. The Granting of the Writ Will not Aid in Administration of the Bankruptcy Act.

(1) There is no conflict between this case and the decisions in the Second Circuit Court and the Fifth Circuit Court which are discussed above. The principles applied by all three courts are clear and the conclusions reached depend upon the facts as found in each case.

(2) This is not a case under either Section 202 of Chapter X or Section 212 of Chapter X but is one involving long established principles of equity. A decision by this Court in this case would not influence the interpretation and application of those provisions of the Bankruptcy Act to cases arising under those provisions.

III.

THE DECISION BELOW DOES NOT CONFLICT WITH ANY RELEVANT EXISTING STATE LAW.

On the assumption that state law governs (which we do not concede) petitioner argues that the applicable law is either that of New York or of Delaware. In either case, this would be no ground for granting certiorari.

A. New York.

Here petitioner relies entirely upon *Tiffany v. Smith*, 124 N. Y. S. 85. In that case it was held that the suit was

barred by laches, and no showing was made that the company had the means to purchase or that the price paid by the endorser was inadequate. Also, in that case a director was purchasing the assets of the company whose obligation he had endorsed, and not the notes of another company to whom he owed a fiduciary duty as a director of that company.

The principles of law which are applicable to the facts of this case have been clearly set forth by the state and federal courts in New York in the following decisions which were relied upon by the courts below and which are completely in accord with the decision of this case:

Meinhard v. Salmon, 249 N. Y. 458, 164 N. E. 545, 62 A. L. R. 1;

Lonsdale v. Speyer, 291 N. Y. S. 495, 249 App. Div. 133 (1936);

Irving Trust Co. v. Deutsch, 73 F. (2d) 121 (2 C. C. A. 1934);

In re: McCrory Stores Corp., 12 F. Sup. 267 (S. D. N. Y. 1935).

B. Delaware.

We disagree with petitioner's statement that there is no relevant decision in Delaware and respectfully refer the Court to the decision of the Supreme Court of Delaware in *Guth v. Loft, Inc.,* 5 A. (2d) 503, affirming 2 A. (2d) 225. The Supreme Court of Delaware there conceded that when a business opportunity comes to a corporate officer or director and is of a nature which is not essential to his corporation and which involves no conflict with its interests, he can embrace it for himself, but the court continued (page 511):

> "On the other hand, it is equally true that, if there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of the corporation's business and is of practical advan-

tage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation, the law will not permit him to seize the opportunity for himself. And, if in such circumstances, the interests of the corporation are betrayed, the corporation may elect to claim all of the benefits of the transaction for itself, and the law will impress a trust in favor of the corporation upon the property, interests and profits so acquired. *Du Pont et al.*, D. C. 242 F. 98, reversed on facts, 3 Cir., 256 F. 129; *Beatty v. Guggenheim Exploration Co.*, 225 N. Y. 380, 122 N. E. 378; *Irving Trust Co. v. Deutsch*, 2 Cir. 73 F. 2d 121, certiorari denied *Biddle v. Irving Trust Co.*, 294 U. S. 702, 55 S. Ct. 405, 79 L. Ed. 1243; *Bailey v. Jacobs, supra; Beaudette, et al. v. Graham et al.*, 267 Mass. 7, 165 N. E. 671; *McKey v. Swenson*, 232 Mich. 505, 205 N. W. 583."

Even if this decision had not been made and we were remitted to the entire body of substantive law, as petitioner suggests, the decision below is clearly in line with the great weight of authority.

In re: Norcor Mfg. Co., 109 F. (2d) 407 (7 C. C. A. 1940) Certiorari Denied 310 U. S. 625;

Price v. Comstock, 121 Fed. 620, 61 L. R. A. 176 (8 C. C. A.);

Canton Roll & Machine Co. v. Rolling Mill Company of America, 168 Fed. 465 (4 C. C. A.);

Dunnett v. Arn, 71 F. (2d) 912 (10 C. C. A.);

Beaudette v. Graham, 165 N. E. 671 (Mass.);

Bonney v. Tilley, 109 Cal. 346, 42 Pac. 439 (1895);

Higgins v. Lansingh, 154 Ill. 301, 40 N. E. 362, 386 (1895);

Farwell v. Pyle-National Electric Headlight Co., 289 Ill. 157, 124 N. E. 449 (1919);

Brewster v. Stratman, 4 Mo. App. 41 (1877);

Lingle v. The National Insurance Co., 45 Mo. 109 (1869).

CONCLUSION.

It is respectfully submitted that the purported conflict between the decision below and the decisions of the Second Circuit and of the Fifth Circuit is one in facts only. There is no conflict with either the decisions of this Court, the state law or the general decisions in this matter. All three of the lower tribunals have concurred in the facts, which facts are amply supported by the record. Petitioner's whole position is hinged upon a disregard of those findings by this Court. There is no question presented that is of great general or public interest and the petition for certiorari should be denied.

Respectfully submitted,

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Van Sweringen Corporation.

(20)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 613

IN THE MATTER OF
THE VAN SWERINGEN CORPORATION,
Debtor.

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY (FORMERLY MIDAMERICA CORPORATION),
Petitioner,

vs.

VAN SWERINGEN CORPORATION,
Debtor,

and

FREDERICK L. LECKIE AND JOSEPH G. FOGG,
TRUSTEES OF VAN SWERINGEN CORPORATION,
Respondents.

(A. B. GOCHENOUR, ET AL., *Intervenors.*)

BRIEF OF INTERVENORS, A. B. GOCHENOUR, ET AL., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 613.

IN THE MATTER OF
THE VAN SWERINGEN CORPORATION,
DEBTOR.

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY (FORMERLY MIDAMERICA CORPORATION),
Petitioner,

vs.

VAN SWERINGEN CORPORATION,
Debtor,

AND

FREDERICK L. LECKIE AND JOSEPH G. FOGG,
TRUSTEES OF VAN SWERINGEN CORPORATION,
Respondents,

(A. B. GOCHENOUR, ET AL., *Intervenors.*)

BRIEF OF INTERVENORS, A. B. GOCHENOUR, ET AL., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

STATEMENT.

The Circuit Court of Appeals affirmed the judgment of the District Court which adopted the recommendation of the Special Master and allowed Petitioner's claim in the sum of $887 with interest at 6% per annum from Octo-

ber 1, 1935, and denied the balance of the claim in excess of $17,000,000, on the ground that Midamerica was a combination in corporate form, participated in by directors of the respective debtor corporations, formed and utilized for the purpose, among other things, of divesting the debtor corporations of their properties or of obtaining claims against them at a sacrifice for the profit of the combination at the expense and to the detriment of the insolvent debtor corporations; that there was bad faith and breach of fiduciary duty; that Midamerica acquired and holds the notes so purchased by it as trustee for the debtor and therefore is not entitled to more than $887, the amount paid, together with interest thereon.

Corrections in Petitioner's Statement of Questions Presented.

Based upon petitioner's assumption that "it stands in the shoes of the Van Sweringens," the first question presented (p. 2) may be simplified: whether the Van Sweringens who dominated and controlled the insolvent corporations, acquired title other than as trustee for the benefit of the creditors of the debtor corporations, in the purchase of collateral securities at a pre-arranged sale whereby the Van Sweringens were to purchase the securities for their own benefit, without notice and opportunity to the creditors of their insolvent corporations to bid at such sale. In the second question (p. 3) the words *"where the director did not seek and could not make a profit"* should be eliminated for the reason that the Special Master found (R. 132) that the Van Sweringens purchased the securities *"at a sacrifice and for the profit"* and "at the expense and to the detriment of the Van Sweringen Corporation" and the District Court, in affirming the Master's finding, found (R. 271) that the Van Sweringens *"stood to profit under their option, as there were some very valuable securities in the lots pur-*

chased'' and *''they were to receive, and did receive, substantial money payments as agreed compensation for managing Midamerica,''* which compensation was $1,000,000 for the 10-year period. The court said (p. 271):

> "To hold that the Van Sweringens received no personal profit or advantage over these debtors, of their own creation, and to which they owed the highest fiduciary relationship, would be to disregard the express provisions of the purchase and option arrangement, the substantial compensation paid, and the necessary implications of the consequent corporate set-up."

In affirming the decision of the Master and of the District Court, the Court of Appeals said (R. 324):

> "It is conceded in the record that 'it was agreed and arranged with the Van Sweringens that by way of salary they were to have a drawing account of $100,000 per year' from the Midamerica Corporation.
>
> "Thus, as a result of their contract with Ball and Tomlinson, consummated by the aforementioned letter, the Van Sweringens, without investing a penny in Midamerica Corporation which purchased at the auction sale the notes and bonds of the debtors with which we are concerned, acquired voting control of Midamerica for a period of ten years and an option to buy 55% of its stock for $8,250 plus five per cent interest; and also assured themselves of an income, from the new corporation of $100,000 per year for the ten year period."

In view of the foregoing, the second question presented by petitioner (p. 3), wherein it is asserted that "the director did not seek and could not make a profit," is not fair or warranted by the record. The second question therefore is:

> In a reorganization proceeding under section 77B, should the rule which forbids a director to profit at the expense of his insolvent company by buying up its notes for a nominal price be applied in a case where the director sought and obtained a profit to himself, without giving the opportunity to the creditors of the

insolvent corporation to bid at the sale, and to enable the director to establish a claim in excess of $17,000,000 for the securities purchased and carried on his books at cost of $887, and should the decision of a Master, approved by the Court and affirmed by the Court of Appeals denying the profit to such a director, be reviewed by the discretionary Writ of Certiorari of this Court?

The statement (pp. 3-4) that in October, 1930, Vaness and C. T. B. "were in a serious need of funds" and the Van Sweringens obtained two loans of $16,000,000 and $23,500,000 from Morgan, and personally guaranteed these loans, is an inaccurate statement. *The loans were not obtained for the corporations* because they were in serious need of funds, but *were obtained for the benefit of the Van Sweringens, who were in serious need of funds, and the corporate credits were used for the purpose of obtaining the loans which were guaranteed by the Van Sweringens personally.* At the date of these loans, the Van Sweringens personally were obligated to maintain $15,000,000 "liquid securities" under *their* personal agreements pertaining to the $30,000,000 note issue. (R. 173-4.) These "liquid securities" which were secured by Alleghany stock shrank in value and it was necessary to substitute different securities. The loans were obtained in order to exchange the Alleghany stock for government bonds which were purchased out of the proceeds of those loans.

It was for such purpose that the Van Sweringens caused C. T. B. to execute the $23,500,000 note to purchase the $500,000 Alleghany stock and to substitute the stock with cash and government securities which was found by the Circuit Court of Appeals in another appeal taken by these intervenors to have been *tinged with fraud.* (*Gochenour* v. *J. P. Morgan & Co.*, 111 F. (2) 378.)

The statement (p. 5) that at the maturity of the notes Vaness, C. T. B. and the Van Sweringens admitted their

inability to pay and that Morgan published a sale on September 13, 1935, to be held September 30, 1935, omitted to state that the admission was made by the Van Sweringens for the purpose of having a sale held *so that they could purchase the collateral for their personal benefit,* as more fully appears from the private correspondence which is in the record. (R. 188, 190, 191.)

Midamerica not only was formed for the purpose of "bidding at the sale" but it was formed under the *preconceived plan* of the written agreement (R. 67) to elect the Van Sweringens as the chief officers of Midamerica with a salary of $100,000 per year for 10 years, and an option to purchase 55% of the common stock. The statement (p. 6) that the option was of no particular benefit as the Van Sweringens could not have elected a majority of the Board of Directors is untrue for the reason that *the Van Sweringens had elected themselves as the chief managing officers of Midamerica and they had one-half of the directorate.* The provisions which called for a change in the management by a vote of five out of six *perpetuated the Van Sweringens in control of this corporation.*

Reasons for Denial of the Writ.

1. The decision below is not in conflict with the decision of the Second Circuit.

2. The decision below is not in conflict with any decisions of state law.

3. The decision below does not conflict with applicable decisions of this court and with the decision of the Fifth Circuit.

4. The decision below followed the rule announced by this court pertaining to the duties of loyalty by fiduciaries.

ARGUMENT.

1. The Decision Below Is Not in Conflict With the Decision of the Second Circuit.

The contention (pp. 11-12) that the decision is in conflict with the decision of the Second Circuit in *In re New York Railways Corporation*, 82 F. (2d) 739, is devoid of merit. The District Court distinguished that case (R. 271) on the ground that there "no fiduciary relationship" existed, while here a *fiduciary relationship existed.* There "a management of independent directors" existed, while *"Here, the Van Sweringens dominated and controlled the debtors." New York Railways* case was also distinguished in *Ripperger* v. *Allyn*, 25 F. Supp. 554. There the court said (p. 555):

> "Directors and those who occupy a similar relation to a corporation may buy up claims held by strangers against it or may purchase from others liens on corporate property without accountability for profits, when the transaction is fair to the corporation and involves no competition with it. The prohibition applicable to strict trustees does not cover such a case. *In re New York Railways Corporation*, 2 Circ., 82 F. 2d 739; *Seymour* v. *Cemetery Assn.*, 144 N. Y. 333, 39 N. E. 365, 26 L. R. A. 859; see *Twin-Lick Oil Co.* v. *Marbury*, 91 U. S. 587, 23 L. Ed. 328; *McKittrick* v. *Arkansas Central Railway*, 152 U. S. 473, 14 S. Ct. 661, 38 L. Ed. 518. **There is no immunity, however, where the failure of the debtor company to buy up the claims for itself was brought about by the fact that the directors or others in control wished to acquire them for themselves. This, as I see it, is the substantial distinction between the Deutsch Case and the New York Railways Case,** both decided recently by the Circuit Court of Appeals of this circuit." (Emphasis supplied.)

(a) The contention (p. 12) that "Midamerica did not buy the notes for $887" is equally without merit. Midamerica not only carried these notes at "cost" on its books in the sum of $887 (R. 109) but *used its bookkeeping entries for the purpose of "substantiating" the cost before the Federal Income Tax Department.* (R. 106.) Whether or not the $887 was the real cost, is of no importance as Midamerica, standing in the shoes of the Van Sweringens, *had the burden to show the real cost* as stated in *First Trust & Savings Bank* v. *Iowa-Wisconsin Bridge Co.*, 98 F. (2) 416. There the Eighth Circuit said at page 425:

> "The rule for the guidance of the court in passing upon all these transactions was stated by the Supreme Court in *Geddes* v. *Anaconda Mining Co.*, 254 U. S. 590, 599, 41 S. Ct. 209, 212, 65 L. Ed. 425, as follows: 'The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, and **where the fairness of such transactions is challenged the burden is upon those who would maintain them to show their entire fairness and where a sale is involved the full adequacy of the consideration.** Especially is this true where a common director is dominating in influence or in character. This court has been consistently emphatic in the application of this rule, which, it has declared, is founded *in soundest morality,* and we now add in the soundest business policy. *Twin-Lick Oil Co.* v. *Marbury,* 91 U. S. 587, 588, 23 L. Ed. 328; *Thomas* v. *Brownville, Ft. Kearney & Pacific R. Co.*, 109 U. S. 522, 3 S. Ct. 315, 27 L. Ed. 1018; *Wardell* v. *Railroad Co.*, 103 U. S. 651, 658, 26 L. Ed. 509; *Corsicana National Bank* v. *Johnson*, 251 U. S. 68, 90, 40 S. Ct. 82, 64 L. Ed. 141.' *Compare McCandless* v. *Furland*, 296 U. S. 140, 158, 56 S. Ct. 41, 46, 80 L. Ed. 121." (Emphasis supplied.)

Abundant authorities are cited on this point that *the burden to show fairness of the purchase price is on the directors.* (76 A. L. R. page 458.)

(b) The fact that in the Morgan appeal the court found that the sale should not be set aside in so far as the *seller* was concerned (111 F. (2d) 378) has no bearing on the question whether Midamerica, standing in the shoes of the Van Sweringens, as the *purchaser*, acquired the assets at the sale in good faith. The Morgan case involved the validity of a sale by a *creditor* who had *no fiduciary relationship* to the corporation and is not charged with knowledge of the intrinsic value of the securities. In that case the objector had the burden to sustain the charge of fraud. Here the claimant, *a fiduciary*, sought to establish a claim in excess of $17,000,000 for property which it carried on its books at cost of $887. The purchaser, *an insider, had actual knowledge of the value of the securities which later yielded a profit of $6,000,000.* The value of these securities to the Van Sweringens or Midamerica, whereby the control of the chain of railroads was obtained, stands in a different category.*

It is on this point that the *Twin-Lick* case is distinguished in 76 A. L. R. 448 where the author points out that there *"no advantage was taken of defendant's position as director nor was any matter known to him at that time of the sale, affecting the value of the property, that was not well known to others interested as it was to himself."*

(i-iii). The argument of petitioner under Points (i-iii) (pp. 15-19) are designed to create "confusion" in rules which are plain and clear.

2. The Decision Is Not Untenable and Is Not in Conflict With Any State Law.

The New York law on which petitioner relies for probable conflict is the rule announced in *Tiffany* v. *Smith*, 124 N. Y. Supp. 85, which petitioner says (p. 20) is "the only

* See Report No. 25 of Senate Committee under S. Res. 71, par. 25, entitled "Allegheny System—Midamerica Corporation."

New York case on the subject." That case involved a sale by a *receiver* and there was no question about failure to give notice to creditors, and the directors did not stand in a fiduciary position to creditors. The *Tiffany* case is cited in *Herring* v. *Curtiss*, 200 N. Y. Supp. 7, 48, on the point that the directors were absolved from a breach of the trust but that decision was *reversed* on appeal in 233 Appellate Division, page 101. The *Tiffany* case relied on, cited the decision in *Marr* v. *Marr*, 72 N. J. Equity 797, but it *overlooked* that the New Jersey Court of Errors *reversed* the decision in 73 N. J. Equity 797, 70 Atlantic, page 375. There it said (p. 378):

> "But we deem it clear that the director, who is also creditor, must, on taking legal proceedings for collection of his debt, relinquish his trust *pro hac vice*, not covertly, but openly, and with fair notice to his company. Whether such notice should be given to the stockholders or to the directors may depend upon circumstances. If the company is equipped with other officers and directors who are actively representing the interest of the stockholders, it may well be that notice to such officers or directors would be deemed sufficient. But it is, as we think, **inconsistent with the duty of a director** (at least under circumstances such as are here presented) **that he should assume an attitude antagonistic to his company, unless he sees to it that the interests of the stockholders, which he, by reason of his personal interest, is for the time disqualified from protecting, are in the charge of other officers** and directors able and willing to protect them, and to whom his notice may be given, **or else sees to it that fair notice of his contemplated action be given** to the stockholders, so that they may take measures to protect themselves."

The rule was followed in *Endicott* v. *Marvel*, 87 Atl. 230 and in *Union Ice Co.* v. *Hulton*, 291 Pa. 416, where the director purchased at a "public sale". In the latter case the Court cited the *Marr* case, *supra*.

Notwithstanding the statement that the *Tiffany* case is

the "only" New York case on the right of a director-creditor to purchase the property of his corporation to protect his creditor's position without notice to the corporation or to its creditors in the event of insolvency, *the contrary appears* in *Claude Neon Lights* v. *Fed. Electric Co.*, 295 N. Y. S. 1-6, 250 App. Div. 510 (1937). See also *Lonsdale* v. *Speyer*, 291 N. Y. S. 495, 249 App. Div. 133, cited in the opinion. (R. 325)

Even in cases where the director-creditor may become a purchaser in order to protect his creditor's position, he must "warn the corporation" that he would "bid" and afford it the opportunity to protect its rights. (*Wilson* v. *Thelan*, 100 P. (2) 923 (Mont. 1940).) There it was said (p. 927):

> "Where there is a forced sale of corporate property *a director who is also a creditor who warns the corporation that he is about to do so, may bid* upon the property without being charged improperly taking an interest adverse to the corporation." (Italics ours.)

No such "warning" was given in the instant case. The authorities on this point are collected in 76 A. L. R. pp. 454-455.

Why the law of Delaware should be applied as contended for (p. 20) is not disclosed. The question here is not whether the Delaware corporation acquired the assets in fraud of creditors but whether *the corporate officers who are residents of Ohio* acquired the assets in breach of *their* trust duties and obligations. At any rate, counsel confess that there is no Delaware decision on this point, and, of course, the decision therefore cannot be in conflict with state law which is non-existent.

3. The Decision Below Follows the Applicable Decision of This Court and Is Not in Conflict With the Decision of the Fifth Circuit.

The contention (p. 21) that the decision in the instant case is in conflict with the rule announced by this court in *Twin-Lick Oil Company* v. *Marbury*, 91 U. S. 587, which is reiterated in many places (pp. 24, 25, 26, 29), was raised below. It was disposed of by the District Court which said (R. 271):

> "Unlike *Twin-Lick Oil Company* v. *Marbury*, 91 U. S. 587, the debtors here acted as promptly to object to the effects of the purchase arrangement as was possible. Certainly, the Van Sweringens never would have raised objection, and with their death the debtors were left with no responsible independent officers until trustees were appointed by the Court. Unlike *Twin-Lick* v. *Marbury, supra*, the debtors or their creditors here never were given a chance to participate in the sale. No action ever was proposed or recorded in the minutes of the debtors that they were unable or unwilling to bid for the obligations and securities or any part of them."

The Court of Appeals' opinion distinguished it in the following language (R. 326):

> "The evidence of manifest good faith of a director in dealing with his company revealed in *Twin-Lick Oil Company* v. *Marbury*, 91 U. S. 587, heavily depended upon by appellant, utterly distinguishes that case from the instant litigation. Moreover, the Supreme Court said (Op. 588, 589): 'That a director of a joint stock corporation occupies one of those fiduciary relations where his dealings with the subject matter of his trust or agency, and with the beneficiary or party whose interest is confided to his care, is viewed with jealousy by the courts, and may be set aside on slight grounds, is a doctrine founded on the soundest morality, and which has received the clearest recognition in this court and in others.'
>
> "From the premise that the Twin-Lick Oil Company

case, *supra*, establishes the right of a director to protect a validly acquired interest as against his corporation, appellant earnestly insists that it should prevail in these suits. We cannot concur. The mere fact that the Van Sweringens were endorsers and guarantors of heavy obligations of the corporations in which they were directors does not avoid the effect of the doctrine that they should not be permitted, directly or indirectly, to derive from their position personal profit or advantages not shared by all stockholders. See *Thomas* v. *Matthews*, 94 O. S. 32, 43."

In commenting on the *Twin-Lick* case in 76 A. L. R. 448, the author points out that there, the property was sold "at a fair and open sale and at a reasonable price; no advantage was taken of defendant's position as director." The court said in its opinion that the sale was made by a trustee "who had the required power necessary to see that the sale was fairly conducted, and who in this respect was the trustee of the corporation, and must be supposed to have been selected by it for the exercise of the power" and the corporation, therefore, was represented at the sale by an *independent* trustee. The opinion also pointed out that the stockholders had notice of the sale and "refused to join with the defendant in the purchase."

In a comment on the *Twin-Lick* case in *Beaumont* v. *Folsom*, Nebraska 1939, the court said (285 N. W. 547, 550) that the right of a director to purchase corporate property at the sale *to protect his creditor's position is subject to the giving of notice and opportunity to the corporation and the independent members of the board* "to participate in arranging the new corporation" which was to bid at the sale. No such notice or opportunity was given by the Van Sweringens to any independent persons.

Petitioner says (p. 22) that the *Twin-Lick* case stands for the "fair doctrine" that "where a director, acting throughout in entire good faith, acquires valid rights

against his company, he may take appropriate steps to protect those rights" and "Midamerica invokes this doctrine here." The misapplication of the doctrine is apparent. It was not "good faith" on the part of Midamerica, standing in the shoes of the Van Sweringens, to invite Morgan to sell the securities and to purchase the securities for themselves, and, after stripping the corporations of the valuable securities, to plunge their corporations into bankruptcy under 77B. Why did they not file the 77B proceedings prior to the sale and thereby enable the creditors to obtain the protection and aid of the bankruptcy court? Such a plan was suggested by the attorney for the corporations. (R. 254-255.) Such course would have placed the debtor corporation, and not the Van Sweringens, in control of the securities. It should also be noted that the Van Sweringens were *trustees for the creditors because of the insolvency of the corporations under the Ohio law.* This distinction was expressly made in *McCrory Stores Corporation,* 12 Fed. Supp. 267. The case was cited with approval in *Security First National Bank* v. *Rindge Land & Navigation Co.,* 85 F. (2d) 557, 562. If the New York law be applicable here as contended by petitioner, then, *the rule announced in the McCrory case* (12 F. S. p. 267) *was adopted in New York* (*Claude Neon Lights* v. *Federal Electric Co.,* 295 N. Y. S. 1, 250 App. Div. 510). There, the Court said (p. 517):

> "In Fletcher's Cyclopedia of Corporations (Permanent ed. § 869) it is stated that the general rule is that directors or other officers may purchase, and enforce, claims against their corporations, at their face value, notwithstanding they were bought at a discount, provided, however, that (1) if such officer owed the duty to his company to purchase the claim for the company instead of for himself he cannot enforce his claim in excess of what he paid for it, and, according to what is apparently held in a few decisions, that (2) if a corporation is insolvent at the time of the purchase the officer cannot enforce his claim for more than he paid

> for it. The rule is reiterated in *Matter of McCrory Stores Corporation* (12 F. Supp. 267), where it is said: 'Under ordinary conditions a director may purchase claims against his corporation at a discount and enforce them for their full amount. (*Seymour* v. *Spring Forest Cemetery Association,* 144 N. Y. 333; 39 N. E. 365; 26 L. R. A. 859; *Glenwood Mfg. Co.* v. *Syme,* 109 Wis. 355; 85 N. W. 432; Fletcher on Corporations, § 2289.) *But the case is different where the corporation is insolvent and is itself in the field to settle the claims. A director who acquires claims under such circumstances may enforce them for no more than the cost of acquisition.*' "

See also *Billings* v. *Shaw,* 209 N. Y. 265 and *Jno. Dunlop's Sons* v. *Dunlop,* 14 N. Y. S. (2) 452 (1940). There the Court said (p. 453):

> "Directors may not act in a dual capacity to their individual advantage. Silence when speech is imperative, concealment when disclosure is necessary, disloyalty when faithfulness is indicated, constitute breaches of fiduciary relationship for which relief in equity may be had."

Such relief was given under the rule that a court of bankruptcy is essentially a court of equity (*Pepper* v. *Litton,* 308 U. S. 295).

In Fletcher Cyc. (Perm. Ed.) in Section 876, after stating the general rule as contended here that an officer may purchase corporate property to protect his endorsement or guarantee, the author points out that *the rule is different where the corporation is insolvent* for by such purchase he, the officer, obtains a preference over the other creditors. In Section 7462 the author cites the Ohio Code, Section 11104, declaring void preferential sales in contemplation of insolvency. See also Section 7469 where the author says (p. 266):

> "*The denial of the right of directors of an insolvent corporation to obtain a preference* by way of security or payment of debts due them by the corporation *is not a rule founded upon the trust fund doctrine,* but

> upon the theory that *it is inequitable that a director,* whose position as to knowledge of conditions and power to act for the corporation gives him an advantage, *should be permitted to protect his own claim to the detriment of others at a time when it is apparent that all the unsecured debts of the corporation are equally in peril,* and that all of them cannot be paid. And some cases take the position that he is not even a creditor as against creditors having no connection with the corporation. However, it is the universal rule in those states which recognize the trust fund doctrine." (Italics ours.)

Ohio is *one of the States which recognizes the trust fund doctrine.* (*Hardware Co.* v. *Castings Co.*, 90 O. S. 171, 106 N. E. 966.) The Van Sweringens were in control of the subsidiary debtor, "its mind, hands and pockets," (*Rabinovitz* v. *Oughton*, 92 F. (2) 297), and were in duty bound to execute their function "with absolute fidelity to both creditors and stockholders" and they or their associates "will not be allowed to secure to themselves advantages over creditors."

The assertion (p. 22) that "the Van Sweringens in good faith lent *their* credit to Vaness" is contrary to the findings of the Master, approved by the District Court and confirmed by the Court of Appeals. The court said (R. 275):

> "The Van Sweringens had caused these notes and bonds to be issued and had hypothecated them with Morgan *to secure their own borrowing* and the debtor's obligations to Vaness Company, their personal and top holding company."

The statement (p. 22) that Vaness "purchased from the public $13,787,000 of the debtor's notes for approximately $7,000,000 in cash" is unfounded. Vaness did not purchase these notes in the open market. It did not pay $7,000,000 in cash. The record shows that these notes were purchased by the Van Sweringen Corporation and not by Vaness. (R. 48.) The cash was not paid by Vaness but was taken out of the "segregated assets" and "assigned securities"

which *belonged to the noteholders*, and the common stock in exchange of the balance of the notes was also furnished by Van Sweringen Corporation and not Vaness. It is true that after these notes were so acquired they were placed by Vaness with Morgan as additional security for its existing loan, as it is shown by its agreement with Morgan prior to the acquisition of these notes. (R. 51-55.) It was very easy for O. P. Van Sweringen, who was then President of the Van Sweringen Corporation and President of Vaness, to take the notes and place them as collateral with Morgan, but this did not vest the title in Vaness as the notes were acquired by Van Sweringen Corporation.

On the one hand petitioner argues (p. 23) that the Van Sweringens had the right to purchase the assets, to reduce their obligation on the guarantee, and on the other hand it is argued (p. 23) that the Van Sweringens "were hopelessly insolvent" and owed in excess of $50,000,000. How did the purchase of the assets help them to reduce their obligation and to place them in a sounder financial position when a deficiency was obtained in excess of $27,000,000?

The contention (p. 24) that the decision is in conflict with the decision of the Fifth Circuit in *Arn* v. *Bradshaw Oil and Gas Co.*, 108 F. (2) 125, is unsound for the reason that the court recognized the rule which forbids a director to purchase the property of his corporation but it said "the application of the principles here fails, because the directors did not misuse their position to obtain the challenged results, and because they have not personally obtained the property of the company." It pointed out that the directors had "ceased" to be directors by their prior resignations and the company had notice and was represented by the receiver. The *Twin-Lick* case was cited on the point that a director may buy at "a clean judicial sale" where the sale is "fair." The *Arn* decision is, therefore, not in conflict with the instant decision.

4. The Decision Below Properly Applied the Rule Announced in Pepper v. Litton, 308 U. S. 295, and Was Founded on Well Settled Equitable Principles Relating to Duties of Loyalty by Fiduciaries.

The contention (p. 26) that the decision over-zealously applied the rule in the *Pepper* case and that, instead of enforcing vigorously a director's duty of loyalty, the effect of the opinion will be precisely the opposite is fallacious. The effect of this decision will tend to prevent trustees from betraying their trust duties and will prevent combinations to defraud the innocent public.

Petitioner's contention (p. 27) that the decision of this court in the *Sanford* case (157 U. S. 312) is not in accord with the instant decision is groundless. In the quotation from the *Sanford* decision it appears that the court distinguished that case from the other cases on the ground that the directors lent their credit for the benefit of the corporation and that the corporations were "going concerns." The court also pointed out that the directors acted "in the utmost good faith." Here, the directors used the corporations for *their private purposes* to relieve themselves from their duty to keep $15,000,000 in "liquid securities" as part of their agreement to float a $30,000,000 note issue. (Ex. 1, R. 173.) *They plunged their corporations into enormous debt* in order to supply this $15,000,000, and are now seeking, in the name of Midamerica, to establish a claim in excess of $17,000,000 against the insolvent corporations, to the prejudice of bona fide creditors, after realizing over $6,000,000 in profits from the acquisition of the securities.

This court followed the rule announced in *Pepper* v. *Litton* in *Sampsell* v. *Imperial Paper & Color Corporation*, 313 U. S. 215, 61 S. Ct. 904, 85 L. Ed. 797. Mr. Justice Douglas, speaking on behalf of the court, stated (p. 218):

"Mere legal paraphernalia will not suffice to trans-

> form into a substantial adverse claimant a corporation whose affairs are so closely assimilated to the affairs of the dominant stockholder that in substance it is little more than his corporate pocket. Whatever the full reach of that rule may be, **it is clear that a family corporation's adverse claim is merely colorable where, as in this case, the corporation is formed in order to continue the bankrupt's business, where the bankrupt remains in control, and where the effect of the transfer is to hinder, delay or defraud his creditors.** *In re Schoenberg,* 2 Cir., 70 F. 2d 321; *In re Berkowitz,* D. C., 173 F. 1013. And see Glenn, Liquidation, §§ 30-32. Cf. *Shapiro* v. *Wilgus,* 287 U. S. 348, 53 S. Ct. 142, 77 L. Ed. 355, 85 A. L. R. 128." (Bold type supplied.)

Compare this with the opinion of the trial court in the instant case (R. 272):

> "Under the option and purchase arrangement, if the Van Sweringens died or failed to satisfy their creditors within ten years, Ball and Tomlinson took all. **It was a mutually satisfactory arrangement for their common protection against those who might try to pursue the Van Sweringen fortunes through the intricate maze of corporate entities.** Thus, it assured control to the Van Sweringens without creditor interference and gave to Ball and Tomlinson, their associates, freedom from the threat of stranger majority in control of the voting stock. **The option was just what it was intended to be, a device for placing the Van Sweringens' interests in the purchased securities and obligations beyond the reach of their and these debtors' creditors.**" (Bold type supplied.)

Conclusion.

It is clear that the decision of the United States Circuit Court of Appeals for the Sixth Circuit, in the instant case, followed the well settled applicable legal principles, universally accepted, in affirming the judgment of the District Court and the findings of the Special Master. Justice has been done in accordance with equity and good conscience.

The petition for writ of certiorari should, therefore, be denied.

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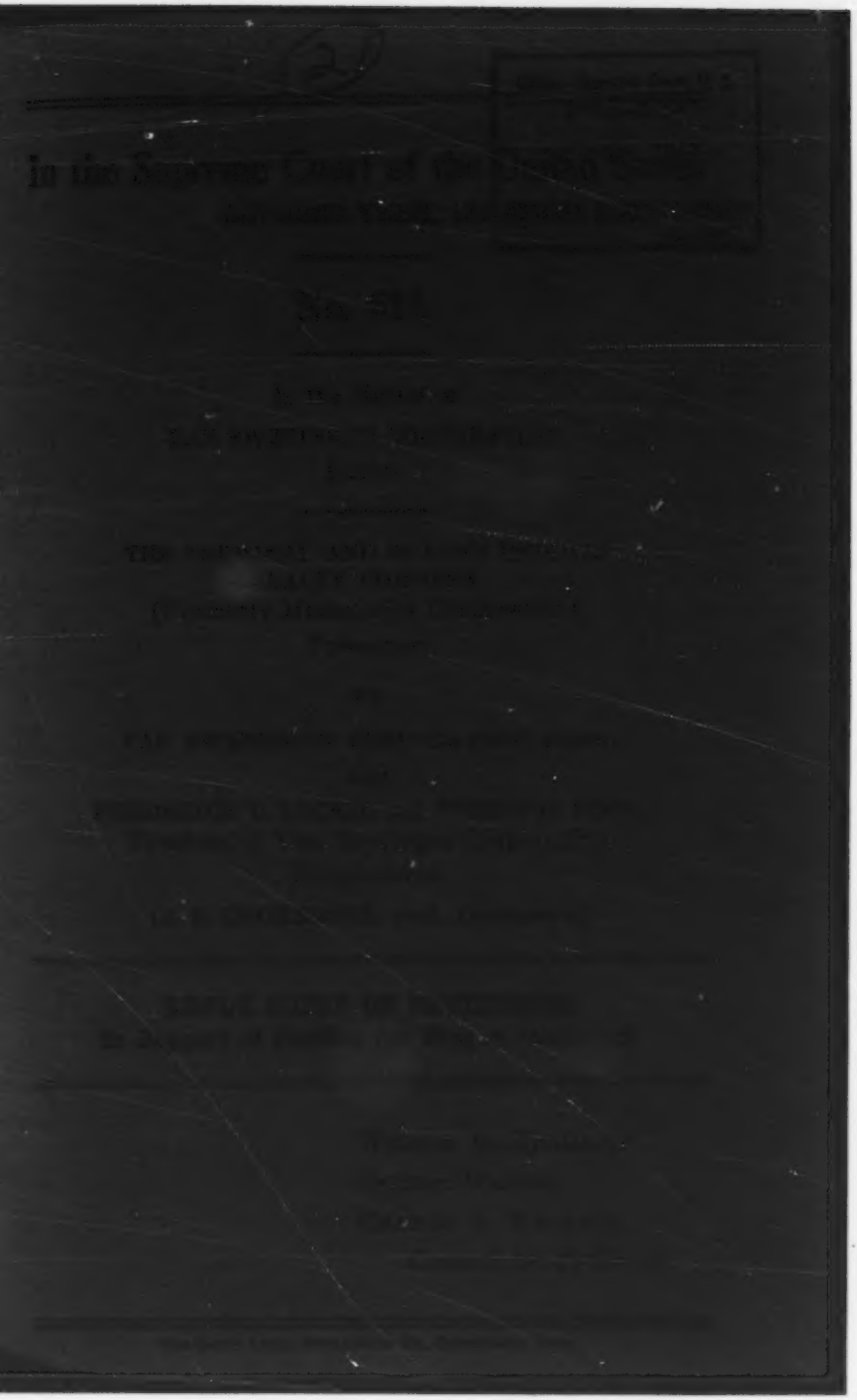

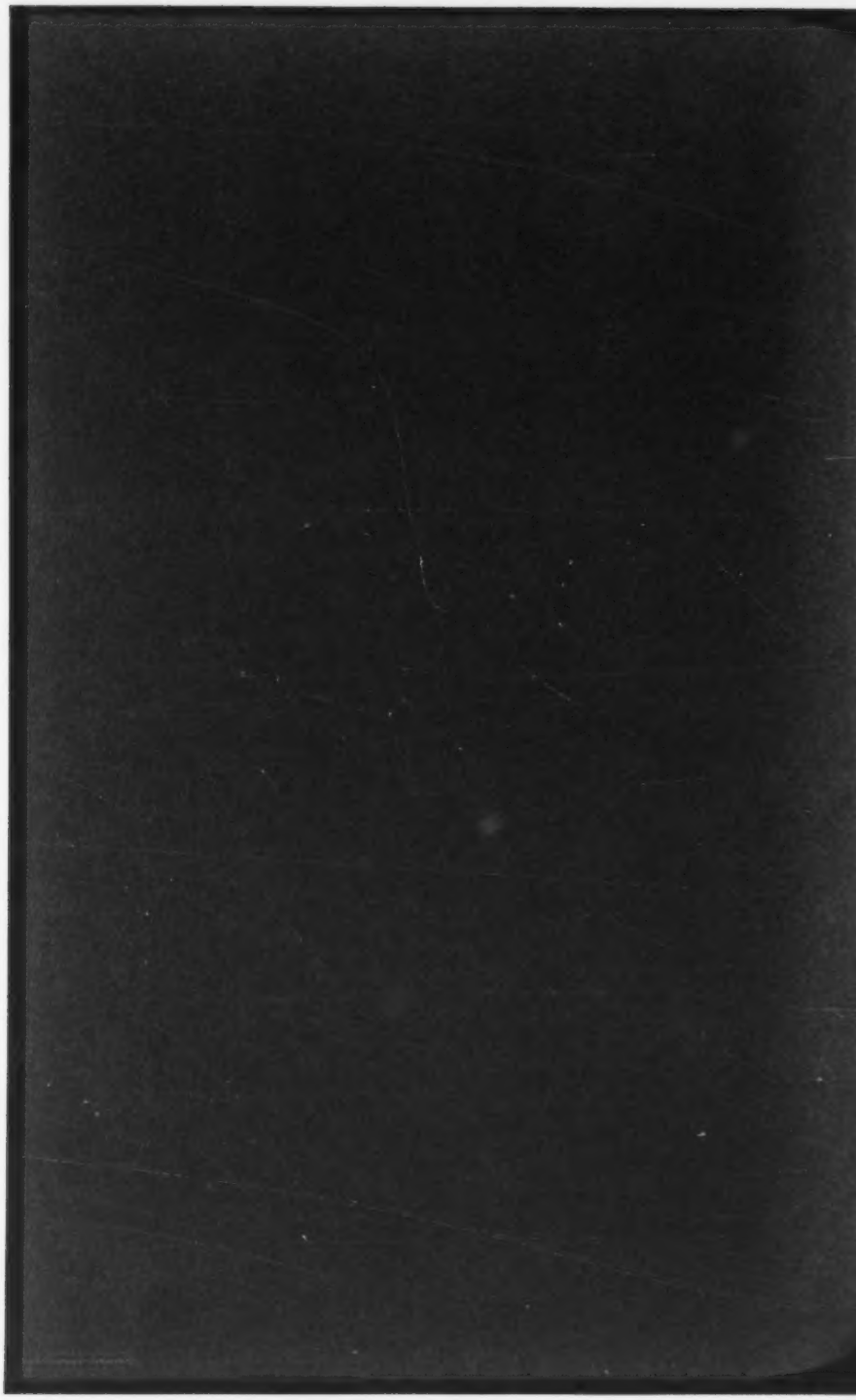

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In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. 613.

In the Matter of

VAN SWERINGEN CORPORATION,

Debtor.

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY
(Formerly Midamerica Corporation),

Petitioner,

vs.

VAN SWERINGEN CORPORATION, *Debtor,*
and

FREDERICK L. LECKIE and JOSEPH G. FOGG,
Trustees of Van Sweringen Corporation,

Respondents.

(A. B. GOCHENOUR, *et al., Intervenors.*)

REPLY BRIEF OF PETITIONER
In Support of Petition for Writ of Certiorari.

Midamerica believes that its reasons for asking certiorari remain unshaken by the briefs in opposition in this case, No. 613, and in the companion cases, Nos. 612 (The Van Sweringen Company) and 614 (The Cleveland Terminals Building Company), and Midamerica is filing no separate reply briefs in those cases. However, in the case of Van Sweringen Corporation (hereinafter sometimes called the "Debtor"), Midamerica desires to file this reply, limited (a) to showing that, under two recent decisions of this

Court, the question here is one of serious consequence both in the law of fiduciaries and in the uniform administration of the Bankruptcy Act, (b) to demonstrating that—despite the Debtor's brief—uniform administration is here impaired by a definite divergence among the circuits, and (c) to answering an unwarranted charge by the Debtor concerning Midamerica's failure to cite certain authorities below.

1. **The Issue Here Concerns a Question of Importance Both in the Law of Fiduciaries and in the Uniform Administration and Interpretation of the Bankruptcy Act. Woods, Court Trustee, v. City National Bank and Trust Co. of Chicago, et al., 312 U. S. 262 (1941), American United Mutual Life Insurance Co. v. City of Avon Park, Florida, 311 U. S. 138 (1940).**

Neither the Debtor's brief nor any of the other briefs in opposition make any effective answer to Midamerica's contention, set forth in subsections (i-iii) on pp. 15-19 of all three of Midamerica's briefs, that (i) the volume of litigation over this type of question in bankruptcy proceedings is large and is increasing, and that, as formerly in the case of landlords' claims, there is need of authoritative clarification in this field; (ii) the decision here, because of the fiduciary questions of law involved, bears directly on § 212 and § 202 of the Bankruptcy Act, 11 U. S. C. A., § 612 and § 602, relating respectively to breach of trust in the acquisition of claims by various types of fiduciaries and to the "scrutiny clause" affecting assignment of landlords' claims; and (iii) the issue here presented is one of serious consequence not only as a matter of fiduciary law, but also in the uniform administration of the Bankruptcy Act.

(a) Debtor's Brief in Opposition. The Debtor states, without discussion, that the granting of a writ will not aid in administering the Bankruptcy Act because this case

does not arise under either § 212 or § 202, but merely involves "long established principles of equity." (Debtor's brief, p. 15.) Of course, the case does not arise under either of these sections: it arises under § 196, 11 U. S. C. A., § 596, providing for the filing and allowance of claims. But the Debtor's suggestion that, because the case merely involves "principles of equity," it will not influence the interpretation and application of important provisions of the Bankruptcy Act which are in this instance essentially a codification of doctrines of equity, will not stand analysis.

The Bankruptcy Act grants the Federal courts exclusive jurisdiction to "allow claims" and to "disallow claims," Section 2a(2), 11 U. S. C. A. § 11a(2); and this general grant was specifically repeated in Section 196 of Chapter X and in Subsection (c)(6) of former Section 77B, both relating to the filing and allowance of claims. Obviously, the duty to allow and disallow claims means the duty to "allow *proper* claims" and to "disallow *improper* claims." If the Act so read, the case would be the same as *Woods, Court Trustee, v. City National Bank and Trust Co. of Chicago, et al.*, 312 U. S. 262 (1941), where this Court was called upon, in a Chapter X proceeding, to decide the correct interpretation of Section 242 of Chapter X, 11 U. S. C. A., § 642, allowing reimbursement for "proper costs and expenses incurred in connection with the administration" of the estate. The Court there granted certiorari "in view of the importance in reorganization proceedings of the power of the District Court over such allowances" (p. 264 of 312 U. S.) and would no doubt have granted review even if the Act had allowed reimbursements simply for "costs and expenses." Although the answer depended ultimately upon the law of fiduciaries and doctrines of equity, there can be no question that the case was one of importance in the administration of the Bankruptcy Act.

Similarly in *American United Mutual Life Insurance Co. v. City of Avon Park, Florida*, 311 U. S. 138 (1940), a

case arising under Chapter IX of the Act, this Court granted certiorari—"in view of the importance of the problems in the administration of the composition and reorganization provisions of the Act" (p. 141, *ibid.*)—and did so in order (a) to interpret the meaning of Section 83(b), 11 U. S. C. A. 403(b), providing that the judge "may allow reasonable compensation" for services rendered and (b) to decide whether an acceptance of the plan by the claimant was "in good faith" within the correct meaning of Section 83(e)(5), 11 U. S. C. A. 403(e)(5). Again, the answer to both questions and the proper construction of both sections were found in basic principles drawn from the law of trusts: thus the Court said that "reasonable compensation" for services rendered necessarily implies "loyal and disinterested service" (p. 147 of 311 U. S.) and concluded that because of claimant's conflicting and undisclosed interests, the compensation was unreasonable and its acceptance of the plan not in good faith.

Both the foregoing decisions illustrate vividly the intimate relation between doctrines of equity and the practical application of the Bankruptcy Act. Nor is this union strange since, as this Court has said:

> "A bankruptcy court is a court of equity, § 2, 11 U. S. C., § 11, and is guided by equitable doctrines and principles except in so far as they are inconsistent with the Act * * *." *Securities and Exchange Commission v. United States Realty & Improvement Co.*, 310 U. S. 434, 455, cited in *American United Mutual Life Insurance Co. v. City of Avon Park, Florida, supra*, at p. 145; and *Pepper v. Litton*, 308 U. S. 295, 304 *et seq.*

(b) The Other Briefs in Opposition. The Van Sweringen Company asserts that although the question here arises in reorganization proceedings, "that is only incidental and accidental," and that this case does not involve "questions in the administration or interpretation of the Bankruptcy Act." (p. 10 of The Van Sweringen Com-

pany brief.) This adds nothing to what is said by Van Sweringen Corporation, and Midamerica believes that this position is demonstrably unsound in light of the reasons for granting certiorari in *Woods, Court Trustee, v. City National Bank and Trust Co. of Chicago, et al.* and *American United Mutual Life Insurance Co. v. City of Avon Park, Florida, supra,* and in light of the blended questions of fiduciary law and bankruptcy law presented by those two cases.

The Cleveland Terminals Building Company (hereinafter called "C. T. B.") makes no attempt whatever to meet Midamerica's contention on this score; and A. B. Gochenour, *et al.*, intervenors, content themselves with the observation that the petitioner's argument is "designed to create 'confusion' in rules which are plain and clear." (p. 8, Gochenour brief in this case, No. 613.)*

2. In Federal Corporate Reorganization Proceedings the Criteria for Allowing or Disallowing Claims of Fiduciaries Should Not Depend on the Particular Jurisdiction Involved.

The field of corporate reorganizations is not an area where conflict among the circuits should be permitted to exist as "merely corollary to a permissible difference of opinion in the state courts." See *Ruhlin v. New York Life*

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* Midamerica naturally does not suggest that every disallowance of a claim in an ordinary case should be reviewed by this Court. The present, however, is emphatically not an ordinary case. It confuses the law of fiduciaries by applying the rule of *Pepper v. Litton, supra,* to a case where *Twin-Lick Oil Co. v. Marbury,* 91 U. S. 587 (1890) and *Sanford Fork & Tool Co. v. Howe, Brown & Company,* 157 U. S. 312 (1895) point the applicable doctrine. It penalizes directors "who have prevented a suspension of the business and enabled the corporation to continue its operations" (contrary to the *Sanford* case, pp. 316, 317). It casts a cloud on many titles to claims bought by officers and directors. And finally, although the present is a striking case, it is only one example of typical and expanding litigation on this subject in corporate reorganizations.

Insurance Co., 304 U. S. 202, 206 (1938). The Bankruptcy Act is a national statute which "was intended for business men and should receive not only a practical, but a uniform construction." *Kreitlein v. Ferger*, 238 U. S. 21, 30 (1915).

Thus, the test of whether a plan under former Section 77B or under Chapter X is "fair and equitable" has been determined for all the circuits by this Court in *Case et al., v. Los Angeles Lumber Products Co., Limited*, 308 U. S. 106 (1939). Similarly, the rules laid down in the *Woods* and *City of Avon Park* cases, *supra*, are the law of the land applicable in all Chapter X and Chapter IX proceedings, respectively. Midamerica believes that by analogy and in the evident interest of uniformity under the Act this principle should govern here, and the briefs in opposition do not seriously challenge this position, but argue mainly that no conflict or divergence in fact exists.

(a) The discretion of this Court in granting a writ should not be affected by counsel's failure to cite a conflicting Circuit Court of Appeals decision to support a position for which decisions of this Court were cited.

The Debtor contends that the failure of petitioner in the court below to rely specifically on *In re New York Railways Corporation*, 82 F. (2d) 739 (C. C. A. 2, 1936) precludes it from urging any conflict with this decision now.*

---

* The Debtor makes the same contention with respect to *Arn v. Bradshaw Oil & Gas Co.*, 108 F. (2d) 125 (C. C. A. 5, 1940), cert. den., 310 U. S. 646. Midamerica did not cite the *Arn* case in its petition as being in the same category with *In re New York Railways Corporation* or as establishing a square conflict among the circuits (see pp. 24-25 of Midamerica's brief in support of its petition), but rather as a recent interpretation and application of *Twin-Lick Oil Co. v. Marbury*, 91 U. S. 587 (1875), and as therefore embodying the applicable doctrine to be followed in this case. Nothing said by the Debtor disturbs this conclusion. (See pp. 24-25 of Midamerica's brief.)

The jurisdiction of this Court to grant certiorari based on conflict among the circuits is, of course, not affected, nor is the discretion of this Court measured, by counsel's choice of authorities in the lower court; and petitioner's failure to cite a particular case in support of a position amply supported by other authorities is in no way analogous, as the Debtor claims, to raising for the first time in this Court a question not raised below. If this were true, no new authority could ever be cited here. Moreover, Midamerica did cite, and heavily relied upon, the two decisions of this Court whose facts make their holdings relevant to the case at bar, and whose philosophy of allowing fiduciaries to protect legitimately acquired interests is the foundation of *In re New York Railways Corporation*: i.e., *Twin-Lick Oil Co. v. Marbury* and *Sanford Fork & Tool Co. v. Howe, Brown & Company, both supra.* These decisions clearly announce the equitable doctrine which should be applied in favor of director-guarantors and which the decision below ignored.

(b) In re New York Railways Corporation is in conflict with the decision below.

The reason for Midamerica's failure to cite *In re New York Railways Corporation* below was simply that it had not then searched the record of that case and, therefore, had not then realized the narrowly restricted sense in which the Court of Appeals for the Second Circuit was using the word "independence" when it talked of the "independence" of the board of the wholly owned subsidiary railway. The case, however, is evidently in conflict.

(i) *The Railway was no more independent than this Debtor.*

This search disclosed that the "independence" consisted solely of the fact that although the parent (the Fifth Avenue Coach Company) at all material times owned 100%

of the subsidiary railway's voting stock, a change in the personnel of the railway's board—evidently engineered by the parent and accomplished by resignations of some of the subsidiary's directors—reduced the number of the parent's own directors, employees, and associates on the subsidiary's board from a majority to a minority. There is no other record evidence of "independence" or lack of control, by the parent, of its subsidiary.

Control is not a metaphysical, but a practical concept, and it may be exercised in various ways. As this Court said in *Southern Pacific Co. v. Bogert*, 250 U. S. 483, 492, in disposing of a contention that control was only indirectly exercised:

> "* * * But the doctrine by which the holders of a majority of the stock of a corporation who dominate its affairs are held to act as trustees for the minority, does not rest upon such technical distinctions. It is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation."

We are here concerned with important rights, and the issue should not be decided by words or labels, but by the fundamental facts and relationships involved.

(ii) *The Railway was insolvent and no more able to buy its Bonds than was this Debtor.*

Unless the *New York Railways* case can be distinguished upon the ground of control, it is not distinguishable at all. This is apparent from the illuminating circumstance that three of the five briefs filed in opposition to Midamerica's petitions (those filed by C. T. B. in Case No. 614, and by Gochenour, *et al.*, intervenors, in Case No. 613 and Case No. 614), do not even attempt to distinguish the *New York Railways* case upon any other ground, and likewise from the evident weakness of the Debtor's two other principal grounds of difference.

Thus the Debtor asserts that "nowhere does it appear that the debtor [the New York Railway] was insolvent at the date its bonds were purchased" (p. 14 of Van Sweringen Corporation brief). But it does appear "that there was no equity in the stock," that the railway "fell behind about a million dollars yearly," and that it was "contemplating reorganization" (p. 741 of the opinion in 82 F. (2d)).

Finally, it is urged that "the debtor was financially unable to buy up its bonds" (p. 14 of Van Sweringen Corporation brief). True, but so was this Debtor, Van Sweringen Corporation. It was admittedly insolvent and had only $13.67 in cash on hand to buy notes which aggregated $13,787,000 in principal amount and which even on the Debtor's own theory cost $887.

The finding of the district court, impliedly approved by the court below, that the Debtor was financially able to buy its notes, is a mere inference wholly unjustified by the only evidence in the record. *The record shows that, apart from the trifling sum of $13.67 on hand, the Debtor had literally no assets whatever except an unsecured claim against its subsidiary, C. T. B., which then had a deficit of more than $29,000,000* (R. 97-99) *and which is not shown either to have paid, or been legally able to pay, one dollar to the Debtor on September 30, 1935, the day of the Morgan auction sale* (R. 33).

Furthermore, as C. T. B. admits in its brief (p. 8), the New York court declared, as an alternative ground of its holding, that "no matter how able the debtor was to buy the income bonds for itself" (page 742 of 82 F. (2d)), its inaction was not owing to the parent's control. We have seen above that "control" is not a valid differentiation between the two cases and that a dominant stockholder, like a director, is a fiduciary. Consequently, even if Van Sweringen Corporation had been able to buy its notes for itself, the cases would still be parallel.

3. Conclusion.

Midamerica respectfully submits: (a) that the conflict between the decision below and *In re New York Railways Corporation* concerns a question of substantial importance both in the law of fiduciaries and in the uniform administration of the Bankruptcy Act; (b) that the decision below fails to follow controlling decisions of this Court, *Twin-Lick Oil Co. v. Marbury* (as recently interpreted and applied in *Arn v. Bradshaw Oil & Gas Co.*), and *Sanford Fork & Tool Co. v. Howe, Brown & Company*; (c) that this Court's discretion should not be affected by whether the *New York Railways* case and the *Arn* case were cited below; (d) that, whether or not the decision below is sound (which Midamerica, of course, strenuously denies), the mixed questions of fiduciary law and of bankruptcy law here presented are each genuinely important in their own right, and both make advisable an authoritative ruling by this Court.

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APPENDIX.

11 U. S. C. A. 11a(2). Creation of courts of bankruptcy and their jurisdiction.

a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * * * *

(2) Allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates;

11 U. S. C. A. § 596. Filing and allowing proofs of claims; objections to allowances.

After the approval of the petition the judge shall prescribe the manner in which and fix a time within which the proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the court. July 1, 1898, c. 541, § 196, as added June 22, 1938, c. 575, § 1, 52 Stat. 893.

(22)

In the Supreme Court of the United States

OCTOBER TERM, 1941.

Office - Supreme Court, U.
FILED
SEP 15 1941
CHARLES ELMORE CROPL
CLERK

No. 614

In the Matter of
THE VAN SWERINGEN CORPORATION,
Debtor,
and
THE CLEVELAND TERMINALS BUILDING COMPANY,
Subsidiary Debtor.

THE TERMINAL AND SHAKER HEIGHTS
REALTY COMPANY
(Formerly Midamerica Corporation),
Petitioner,

vs.

THE CLEVELAND TERMINALS BUILDING COMPANY,
Respondent.

(A. B. GOCHENOUR, ET AL., *Intervenors.*)

PETITION FOR A WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
For the Sixth Circuit, and
BRIEF IN SUPPORT THEREOF.

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In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. .....

In the Matter of
VAN SWERINGEN CORPORATION,
Debtor,
and
THE CLEVELAND TERMINALS BUILDING COMPANY,
Subsidiary Debtor.

THE TERMINAL AND SHAKER HEIGHTS
REALTY COMPANY
(Formerly Midamerica Corporation),
Petitioner,

vs.

THE CLEVELAND TERMINALS BUILDING COMPANY,
Respondent.

(A. B. GOCHENOUR, *et al., Intervenors.*)

PETITION FOR A WRIT OF CERTIORARI

To the United States Circuit Court of Appeals
For the Sixth Circuit.

The Terminal and Shaker Heights Realty Company (successor by change of name to Midamerica Corporation and hereinafter referred to in this petition and supporting brief as "Midamerica") prays that a writ of certiorari be issued to review an order of the Circuit Court of Appeals for the Sixth Circuit entered in this cause on April 16, 1941. This order affirmed an order of the District Court for the Northern District of Ohio, Eastern Division, disallowing, except for $2.00, a claim by Midamerica against The Cleve-

land Terminals Building Company (hereinafter in this petition and supporting brief called "the Debtor") in the principal amount of $1,200,000, evidenced by the Debtor's second mortgage bonds.

Midamerica's petition for a rehearing below was denied on June 25, 1941. (R. 323.)*

OPINION BELOW.

The opinion of the Circuit Court of Appeals for the Sixth Circuit (R. 178-186) is reported in 119 Fed. (2d) 231 (1941).

JURISDICTION.

The jurisdiction of this Court is invoked under Section 24(c) of the Bankruptcy Act (U. S. C. A. Title 11, Section 47(c)) and under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. C. A. Title 28, Section 347).

QUESTIONS PRESENTED.

(1) Did Midamerica acquire good title to the bonds of the Debtor which it purchased from J. P. Morgan & Co. at public auction sale on September 30, 1935, as a part of the collateral securing a $16,000,000 loan from J. P. Morgan & Co. to The Vaness Company and a $23,500,000 loan to the Debtor, or was Midamerica debarred from acquiring good

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* The Circuit Court of Appeals for the Sixth Circuit by the same decision in 119 Fed. (2d) 231 (1941) dealt with the two companion cases of *Midamerica v. The Van Sweringen Company* and *Midamerica v. Van Sweringen Corporation* and likewise disallowed, except for nominal amounts, claims of Midamerica against The Van Sweringen Company and Van Sweringen Corporation. In the three cases taken together, claims of Midamerica aggregating $21,248,697, for which all three debtor companies admittedly received full value, were allowed for only $890. Midamerica has filed petitions for certiorari in these two related cases which were argued together below and which involve substantially the same questions of fact and law.

All references are to the record below, except as otherwise indicated.

title because O. P. and M. J. Van Sweringen were officers and directors of Midamerica and also directors of the Debtor, M. J. Van Sweringen being also an officer of the Debtor?

(2) In the reorganization proceedings of the Debtor under Section 77B (now Chapter X of the Bankruptcy Act), should the rule which forbids a director to profit at the expense of his insolvent company by buying up its bonds at a discount be applied to a case where the director did not seek and could not make a profit, but only sought to reduce a personal liability resulting from his guarantee of a $16,000,000 loan to The Vaness Company and a $23,500,000 loan to the Debtor, for which loans the bonds of the Debtor were pledged as collateral?

(3) Even if O. P. and M. J. Van Sweringen were personally disqualified from buying the bonds of the Debtor, was Midamerica also disqualified despite the fact that it was wholly owned by third parties?*

STATEMENT.

In this case directors who had personally guaranteed $39,500,000 of loans to their companies were denied the right, upon foreclosure of the loans, to purchase part of the pledged collateral in order to protect themselves against liability on their guaranties.

(a) The $39,500,000 Loans of J. P. Morgan & Co. to The Vaness Company and the Debtor.

In October, 1930, The Vaness Company, a holding company of O. P. and M. J. Van Sweringen (hereinafter in this

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* For the purpose of presenting the reasons why certiorari should be granted, and only for that purpose, Midamerica assumes that it stands in the shoes of the Van Sweringens, and therefore makes no point at this time of Question (3). Midamerica, however, reserves the right, if certiorari is granted, to contend, as it has contended throughout, that wholly different and additional defenses are available to it from those which would be available to the Van Sweringens themselves.

petition and supporting brief called "Vaness"), and the Debtor (wholly owned by Van Sweringen Corporation, which was in turn controlled by Vaness), were in serious need of funds, and O. P. Van Sweringen, on their behalf, entered into negotiations with J. P. Morgan & Co. to secure a loan of $16,000,000 to Vaness and $23,500,000 to the Debtor. (R. 123-124, 243, 263.) J. P. Morgan & Co. would not make the requested loans except upon two conditions: (a) that the Van Sweringens personally guarantee payment of both the loans; and (b) that approximately $15,000,000 of debts of Vaness be paid before the loans were made (R. 123-124, 243, 263.)

Both conditions were met. (R. 190.) The $15,000,000 of Vaness debts were cancelled in consideration of their assumption by the Van Sweringens personally (R. 139-140), who thereby made a contribution to the surplus of Vaness of nearly $15,000,000, and the Van Sweringens personally guaranteed the two loans aggregating $39,500,000, which were made on October 31, 1930. (R. 123-124, 243, 263.)

The Vaness loan was secured by the pledge of virtually all the securities belonging to Vaness, among which were $270,000 of the Debtor's bonds (R. 33); and the loan to the Debtor was secured by the pledge of virtually all the Debtor's securities, including $930,000 of its own bonds. (R. 32-33.) The enforceability of this $1,200,000 block of bonds has never been questioned except in the hands of Midamerica, since all the bonds were issued for cash. (R. 32-33, 122, 243, 263.)

After 1930, economic conditions became worse.* Vaness and the Debtor were unable to pay the interest on their loans and with the consent of the Van Sweringens as guarantors, secured an extension of time for the payment of interest and gave interest notes, also guaranteed by the

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* This Court may take judicial notice of this trend, *Great Northern Ry. Co. v. Weeks*, 297 U. S. 135 at 149.

Van Sweringens. (R. 126, 142, 191.) From August, 1934, to the maturity of the loans on May 1, 1935, O. P. and M. J. Van Sweringen made repeated but unsuccessful efforts to refund or extend them (R. 124, 144-145, 243, 263), and at maturity Vaness, the Debtor, and the Van Sweringens admitted their inability to pay them. (R. 168.)

On September 13, 1935, J. P. Morgan & Co. published a notice of the sale of the collateral securing the Vaness and Debtor's loans, to be held September 30, 1935. (R. 52-59.)

The notice of sale divided all the collateral to be sold into 58 parcels comprising four groups. The $270,000 of the Debtor's bonds were Parcel 18, included in Group 1, and the $930,000 block were Parcel 51, included in Group 3. (R. 37-38.) The parcels were first to be offered for sale separately and then in groups, and if the group bid exceeded the aggregate of the parcel bids, all the parcels were to be sold as a group. (R. 55-56.) Any bidder desiring to qualify was required to deposit, in cash or by certified check, by 11 o'clock on the day of the sale, the various amounts specified in the notice of sale. The amount required to qualify to bid on Parcels 18 and 51 was $250 in each case, but the amount required to bid on Group 1 was $270,000 and on Group 3 was $37,500. (R. 57-58.)

Groups 1 and 3 comprised securities of the companies which were being managed by the Van Sweringens. (R. 177.) The sale was to be conducted by Adrian H. Muller & Son, well known securities auctioneers of New York, and was widely advertised for two weeks in newspapers of general circulation in New York City and widely publicized by news comments throughout the United States. (R. 132, 243, 263.) This was in accord with the stated purpose of J. P. Morgan & Co. "to give the widest notice to all possible bidders." (R. 176.)

At the time of the auction sale the Debtor was hopelessly insolvent. Its liabilities amounted to approximately $86,000,000 (R. 85), and even on the basis of book value

of assets, liabilities exceeded assets by approximately $29,000,000. In October, 1936, just a year after the sale, the Debtor—along with its parent, Van Sweringen Corporation—was forced to initiate proceedings for reorganization under Section 77B of the Bankruptcy Act which are still pending. (R. 2.)

(b) The Formation of Midamerica Corporation and the Purchase at the Morgan Auction.

Midamerica was formed on September 28, 1935, for the purpose of bidding at the Morgan public auction sale for the securities of those companies which were being managed by the Van Sweringens. (R. 35, 60-62.) All the capital stock of Midamerica was subscribed for and purchased by George A. Ball of Muncie, Indiana, and G. A. Tomlinson of Cleveland, Ohio, at a cost of $2,015,000, being 20,000 shares of preferred stock at $100 per share, and 15,000 shares of common stock at $1.00 per share. (R. 35, 60-62, 131.) Ball and Tomlinson were willing to invest their money only upon the assurance of continued Van Sweringen management (R. 60); and to this end they granted to O. P. and M. J Van Sweringen a ten-year non-assignable option to purchase at cost 55% of the common stock of Midamerica at any time when the Van Sweringens could satisfy five of the six directors of Midamerica that they had "paid or adjusted any and all claims" against them based upon existing or future "commitments or relationships." (R. 61.)

The original directors of the corporation, chosen by Ball and Tomlinson as the sole stockholders, were George A. Ball, G. A. Tomlinson, F. B. Bernard of Muncie, Indiana (a close business associate of Ball who had had no previous connection with the Van Sweringens), O. P. and M. J. Van Sweringen, and Charles L. Bradley (a close business associate of the Van Sweringens). (R. 36, 131.)

Even if the Van Sweringens had voted the optioned shares, which they never did (R. 138), they could not have

elected a majority of the board of directors because of the provision in the articles of the corporation for cumulative voting, which limited to three the number of directors which 55% of the common stock could elect. Six directors were provided for and restrictions in the corporate articles and regulations required the vote of five out of these six for (1) enlarging the board, (2) merger, consolidation, or sale of substantially all the corporation's assets, (3) issuance of any new shares, and (4) initiation of any amendments to the corporation's articles or regulations. (R. 62-67.) Thus, although the Van Sweringens were the chief executive officers, they did not—and could not—control the board.

O. P. Van Sweringen was elected president and M. J. Van Sweringen vice-president. Other members of the Van Sweringen administrative organization were elected to the other offices. (R. 36.)

On September 30, 1935, at a meeting of the board of directors attended by all the directors except Bradley, it was resolved that the corporation should qualify as a bidder for Group 1 (embracing Vaness collateral) and for Group 3 (embracing Debtor's collateral) to be sold at the Morgan sale and that the president or his nominee be authorized to bid for all or any part of the securities in Group 1 and Group 3. (R. 70.) The sale was held on the same day.

After the securities were offered by parcels, Midamerica made a group bid on the securities in Group 1 and Group 3 which was in excess of the aggregate bids on individual parcels, and all the parcels in these groups were, therefore, sold to it. (R. 37.) The purchase price for Group 1 was $2,803,000 and the purchase price for Group 3 was $318,000. (R. 37, 38.) The aggregates of the parcel bids for the respective groups were $2,802,102 and $317,127. (R. 92-96.) Included in Groups 1 and 3 were the bonds on which the claim against the Debtor is founded. (R. 37, 38.) Also purchased were stock and notes of Van Sweringen

Corporation, large amounts of stock of Alleghany Corporation (a railroad holding company theretofore controlled by Vaness), and numerous other securities of Van Sweringen enterprises. (R. 38, 94-96.) A list of all the 28 parcels comprising Group 1 and the 20 parcels comprising Group 3 appears in Appendix A of petitioner's supporting brief.

For purposes of accounting, it was necessary for Midamerica to establish a cost basis for the securities purchased. Accordingly, on October 31, 1935, J. J. Anzalone, treasurer of Midamerica, requested from the auctioneer a list of the individual bids at the auction. On the basis of this he established a book cost of the various parcels. For those parcels on which there were individual bids he took the individual bids. For those parcels on which there was no individual bid he arbitrarily used the sum of $1.00. However, since the bulk bid exceeded the parcel bids, this left an excess $887, which was arbitrarily assigned to the notes of Van Sweringen Corporation. The entries on this basis were $1.00 for each of the two blocks of the Debtor's bonds and $887 for the notes of Van Sweringen Corporation. (R. 38, 39.)

Inherent in "participation in the management and direction" of Midamerica by the Van Sweringens was the payment to them of a reasonable compensation. The compensation took the form of a drawing account which amounted to $100,000 per year for their joint services. (R. 257.)

Both O. P. and M. J. Van Sweringen were dead before the end of 1936. (R. 36.) Each was liable upon indebtedness aggregating more than $50,000,000 (R. 132) (created mainly by their guaranties of the obligations of Vaness and the Debtor) and each had relatively negligible assets. (R. 132-133.) They died without paying or adjusting any of their debts existing at the time of the formation of Midamerica, and the option died with them. (R. 41, 61, 136.)

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals for the Sixth Circuit erred—

(1) In holding that Midamerica's claim of $1,200,000 against the Debtor should be disallowed except to the extent of $2.00 and in affirming the order of the District Court to that effect;

(2) In holding that the guaranty by O. P. and M. J. Van Sweringen of J. P. Morgan & Co.'s $16,000,000 loan to Vaness and $23,500,000 loan to the Debtor had no bearing upon the right of the Van Sweringens to protect themselves against loss and continuing liability through the acquisition of an interest in the Debtor's bonds as a portion of the collateral which secured the two loans;

(3) In failing to apply the doctrine of *Twin-Lick Oil Company v. Marbury,* 91 U. S. 587 and *Sanford Fork & Tool Company v. Howe, Brown & Company,* 157 U. S. 312, holding that a director has the right to protect legitimately acquired interests;

(4) In finding that the Van Sweringens realized a profit from Midamerica;

(5) In completely disregarding the corporate entity of Midamerica and treating it as a creature of the Van Sweringens;

(6) In finding bad faith on the part of the Van Sweringens.

REASONS FOR GRANTING THE WRIT.

1. The Decision Below is in Conflict with a Decision of the Circuit Court of Appeals for the Second Circuit on a Matter of Importance in the Administration of the Bankruptcy Act.
2. If the Conflict with the Circuit Court of Appeals for the Second Circuit Relates to a Question Which is Controlled by State Law, the Decision Below is Probably Untenable and is in Conflict with the State Law.

3. The Decision Below Conflicts With Applicable Decisions of this Court and of the Circuit Court of Appeals for the Fifth Circuit on an Important Question in the Law of Corporate Fiduciaries.

4. The Decision Below, by an Overzealous Application of *Pepper v. Litton*, 308 U. S. 295, Ignores Well-Settled Principles of Equity as Declared by This Court and, in Fact, Undermines a Director's Duty of Loyalty.

Petitioner's brief in support of this petition is annexed hereto.

WILLIAM H. THOMPSON,
EVERETT WARNER,
CHARLES S. WACHNER,
Counsel for Petitioner.

In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. .....

In the Matter of
VAN SWERINGEN CORPORATION,
Debtor,
and
THE CLEVELAND TERMINALS BUILDING COMPANY,
Subsidiary Debtor.

THE TERMINAL AND SHAKER HEIGHTS
REALTY COMPANY
(Formerly Midamerica Corporation),
Petitioner,

vs.

THE CLEVELAND TERMINALS BUILDING COMPANY,
Respondent.

(A. B. GOCHENOUR, *et al., Intervenors.*)

BRIEF OF PETITIONER

In Support of Petition for a Writ of Certiorari.

In support of its petition for a writ of certiorari in this case, Midamerica files herein its brief and relies upon the reasons listed in its petition as more fully set forth below.

REASONS FOR GRANTING THE WRIT.

1. The Decision Below is in Conflict with a Decision of the Circuit Court of Appeals for the Second Circuit on a Matter of Importance in the Administration of the Bankruptcy Act.

In *In re New York Railways Corporation*, 82 Fed. (2d) 739 (C. C. A. 2, 1936) cert. den. under the name of *Brukenfeld et al. v. New York Railways Corporation et al.*, 298 U. S. 687 (1936) the question was the enforceability in full by the Fifth Avenue Coach Company of bonds of its subsidiary-debtor, the New York Railways Corporation, then in reorganization under Section 77B. Holding 100% of the common stock and having exclusive voting rights, the parent was a fiduciary. *Southern Pacific Co. v. Bogert*, 250 U. S. 483, 492 (1919). The parent, prior to the 77B proceedings, had purchased $11,000,000, or 54%, of its subsidiary's income bonds at 10% of their face value, and objection was made to the allowance of the parent's claim on these bonds for more than their cost to it. The court held that, because a majority of the debtor's board were "independent" and owed no "allegiance" to the parent, the debtor's failure to acquire its bonds for itself was not owing to improper influence. The parent had not "actively prevented" the purchase of these bonds by the debtor, and hence the court said:

> "The failure of the debtor to so act was undoubtedly due to its financial inability rather than to any other fiduciary faithlessness." (p. 741 of 82 Fed. (2d)).

Here, as in the *New York Railways* case, the failure of the Debtor to acquire its bonds was undoubtedly due to its financial inability rather than to fiduciary faithlessness. This is so for two reasons:

(a) Midamerica did not buy the Debtor's bonds for $2.00. Midamerica bought 28 parcels of securities in Group 1 for $2,803,000, by a group bid and 20 parcels in Group 3 for $318,000 by a group bid. (R. 37, 38.) In Appendix A

hereof appears a tabulation of these 48 parcels as listed in J. P. Morgan & Co.'s notice of sale. On the day of the sale no consideration was, or had been, allocated to the Debtor's bonds or to the other parcels within Group 1 and Group 3 for which no individual bids were made. Midamerica's subsequent allocation—for accounting purposes —of $1.00 to each of these parcels (except for the arbitrary allocation of $887 to $13,787,000 of Van Sweringen Corporation Gold Notes) does not establish that Midamerica could have bought, or did buy, these parcels individually for $1.00.

(b) Even if Midamerica's group purchase is interpreted as meaning that Midamerica purchased the Debtor's bonds for $2.00, neither the record nor sound business judgment warrants the inference that J. P. Morgan & Co. would have sold the Debtor's bonds in two separate parcels for $2.00, or, if so, that such a sale would have been made to this Debtor. The qualifying deposit for parcel 23 and for parcel 51 was $250 in each case. The public auction itself was conducted at arms' length, and the court below, in related litigation involving the validity of J. P. Morgan & Co.'s loan to the Debtor, *Gochenour v. J. P. Morgan & Co.*, 111 Fed. (2d) 378 (C. C. A. 6, 1940), found the sale to be fair and free from collusion. Nor is there evidence to justify the belief that any antecedent plan by the Debtor in advance of the auction to retire more than $1,200,000 of valid indebtedness by bidding a nominal sum would have been reasonable or practicable.

Yet the Debtor has consistently argued—and the two lower courts apparently believed—(i) that this insolvent Debtor could have acquired more than $1,200,000 of its bonds by bidding $2.00, and (ii) that the Van Sweringens were guilty of gross dereliction in not foreseeing and acting upon this possibility on the Debtor's behalf. It is respectfully urged that this argument ignores realities.

The truth is that here as in *In re New York Railways Corporation, supra,* the failure of the Debtor to act was un-

doubtedly due to its financial inability and not to prevention by the Van Sweringens or anyone else of a plan by the Debtor to purchase for itself.

It may be contended that the cases are distinguishable in one respect: i.e., the Van Sweringens undoubtedly controlled the Debtor, whereas the court said in the *New York Railways* case that the board of the subsidiary company was independent and that there was no ground to infer from its inaction any improper influence by the parent.* This distinction is more apparent than real.

As appears from the opinion, the "independence" of the New York Railway board consisted of the fact (see p. 741 of 82 Fed. (2)) that after a period of admitted domination through interlocking directors, the board was reshuffled shortly before the parent's buying program began—so that thereafter only a minority of the board was interlocking. But it is plain from the course of events that in every practical sense, the parent, with 100% voting rights, controlled its subsidiary.**

Thus the parent's plan for acquisition of the bonds was wholly inconsistent with their acquisition by the subsidiary. The parent knew that its stock investment in the subsidiary was of doubtful value, that reorganization was imminent, and that its continued control was threatened unless it could acquire a majority of the subsidiary's income bonds (p. 741, *ibid*). Yet the court held that its action was entirely proper.

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* *In re New York Railways Corporation* was distinguished by the District Court below on this ground. (R. 257.)

** The identical board, as reconstituted in April, was retained in office by the parent at its annual meeting one month later, and the same board continued in office thereafter for two more years. See Petition for Certiorari, page 12, in the United States Supreme Court, October term 1935, No. 1050, filed by Carl Brukenfeld, Louis Krones and Philip Kerby, as a preferred stockholders committee; see also record in that case 1234, 1236, 1251, 1375 and 1236.

It follows, therefore, that in the Second Circuit a dominant stockholder, who is unquestionably a fiduciary, but who sees its investment and control threatened, may purchase at a discount a majority of its subsidiary-debtor's bonds of a given issue and may thus protect its position by enforcing the bonds in full in subsequent 77B proceedings; provided only that the debtor itself lacks funds for such purchase and that the fiduciary does not "actively prevent" the debtor's purchase on its own behalf. In the Sixth Circuit, on the other hand, dominant directors, under strikingly similar circumstances, must hold what they buy in constructive trust for the debtor.

Nor does this divergence between the two circuits concern a question of infrequent occurrence or slight significance in the administration and interpretation of the Bankruptcy Act.

(i) In no less than eleven cases* arising under former Section 77B or present Chapter X of the Bankruptcy Act, the enforceability of a claim has been attacked on the ground that the acquisition of such claim involved a violation of fiduciary duty or kindred inequitable conduct.

These cases do not present fraud, as in *Pepper v. Litton*, 308 U. S. 295 (1939), nor direct dealings by an officer

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* *In re McCrory Stores Corporation*, 12 Fed. Supp. 267 (1935); *In re New York Railways Corporation*, 82 Fed. (2d) 739 (C. C. A. 2), cert. den. 298 U. S. 687 (1936); *In re Celotex Co.*, 12 Fed. Supp. 1 (1935); *Security-First National Bank of Los Angeles, et al. v. Rindge Land & Navigation Company, et al.*, 85 Fed. (2d) 557 (C. C. A. 9, 1936); *In re McEwen's Laundry, Inc.*, 90 Fed. (2d) 872 (C. C. A. 6, 1937); *In re Radio-Keith-Orpheum Corp.*, 106 Fed. (2d) 22 (C. C. A. 2, 1939); *In re Utilities Power & Light Corp.*, 29 Fed. Supp. 763 (1939); *In re Norcor Manufacturing Company*, 109 Fed. (2d) 407 (C. C. A. 7), cert. den. 310 U. S. 625 (1940); *The Terminal and Shaker Heights Realty Company v. The Van Sweringen Company, The Terminal and Shaker Heights Realty Company v. The Van Sweringen Corporation, The Terminal and Shaker Heights Realty Company v. The Cleveland Terminals Building Company*, all reported in 119 Fed. (2d) 231 (C. C. A. 6, 1941).

or director with his company as in *Pepper v. Litton.* They are concerned with purchases of claims against the debtor company by officers or directors who acquire such claims from third persons.

Except for claims of landlords, in respect of which this Court has now laid down definitive rules,* the claims of fiduciaries, as shown by the history of Section 77B and Chapter X proceedings, have caused most confusion and uncertainty. Moreover, since investment by corporate officers and directors in the securities of their companies is a widespread and generally understood business practice, the lower federal courts will be increasingly confronted with litigation until definitive rules in this field also have been prescribed by this Court.

(ii) In several of these so-called "fiduciary" cases the lower courts have correctly felt called upon to determine the proper interpretation, scope and effect of two sections of the Bankruptcy Act closely related to the question in this case. Section 202 (U. S. C. A. Title 11, Section 602) provides in material part that the court shall scrutinize the circumstances of an assignment of a future rent claim and the amount of the consideration paid for such assignment in determining the amount of damages allowed the assignee thereof. Section 212 (U. S. C. A. Title 11, Section 612) provides in material part that, in the case of any agent or committee purporting to represent creditors or stockholders, the court may limit any claims or stock acquired by such agent or committee in contemplation or in the course of a proceeding under Chapter X to the actual consideration paid therefor.

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* *Kuehner, et al., Trustees v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 445 (1937); *City Bank Farmers Trust Co., Assignee v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 433 (1937); *Meadows v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 464 (1937); *Schwartz, et al. v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 456 (1937).

One or the other of these sections (set forth in Appendix B hereof) or their predecessors in Section 77B were the subject of careful consideration in four of the cases above noted, i.e., *In re McCrory Stores Corporation, In re McEwen's Laundry, Inc., Security-First National Bank of Los Angeles, et al. v. Rindge Land & Navigation Co.,* and *In re Celotex Co.,* all *supra.*

The reason for this is plain: Section 212 is a legislative declaration that where claims or stock are acquired by an agent or committee in a representative capacity under circumstances which may involve breach of fiduciary duty, the claimant shall not enforce the claim or stock for more than its cost to him. Section 202 relates to assignment of landlords' claims under circumstances which, as a practical matter, are apt to involve a breach of fiduciary duty. See *In re McCrory Stores Corporation, supra,* the earliest and most frequently cited case in this field.

Consequently, the interpretation and correct application of these two specific provisions of the Bankruptcy Act will in all probability be influenced by the decision of this case.

(iii) It follows from (i) and (ii) above that the present question—although it probes deeply into the law of corporate fiduciaries—is not merely a question of state or local law. Midamerica recognizes that under the decision in *Ruhlin v. New York Life Insurance Co.,* 304 U. S. 202 (1938), conflict among the circuits on the same matter "is not of itself a reason for granting a writ of certiorari" (p. 206, *ibid*) because, since *Erie Railroad Co. v. Tompkins,* 304 U. S. 64 (1938), such conflict "may be merely corollary to a permissible difference of opinion in the state courts." (p. 206 of 304 U. S.)

In the present instance, however, the conflict does not concern a purely local matter like the construction of an insurance contract as in the *Ruhlin* case, *supra,* but on the contrary strikes to the heart of the administration of a

national law. The purpose and effect of the Federal reorganization statutes in supplanting equity receiverships is familiar history, *Continental Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co. et al.*, 294 U. S. 648, 672 (1935); and the result is that the Federal courts, sitting in bankruptcy and reorganization proceedings, are the forum in which the validity of discount purchases of claims by corporate officers and directors is today tested with the greatest frequency. The volume of litigation in the Federal courts on the subject of discount purchases by fiduciaries has previously been noted (p. 15, *supra*). In two specific sections of the Bankruptcy Act, Sections 212 and 202, dealing with analogous situations, Congress has itself legislated on this subject. Thus, for example, if the present case had been one arising under Section 212 and the Debtor, by favor of that specific section, had set up precisely the same defense as here, the "construction and validity" of a provision of the Bankruptcy Act would in all probability have been squarely involved.*

The Federal Constitution (Article 1, § 8, Cl. 4) vests Congress with the power "to establish * * * uniform Laws on the subject of Bankruptcies throughout the United States." This Court, in varying factual situations, has expressly recognized the desirability of adhering to a policy of uniformity so far as possible. In *Kreitlein v. Ferger*, 238 U. S. 21 (1915) the Court (in considering an objection to a sufficient listing of a creditor's name) said:

> "* * * This objection is more difficult of solution than any of the others presented by this record. But, like them, it must be considered in the light of the fact that the statute was intended for business men and should receive not only a practical but a uniform construction. Its provisions are applicable to creditors

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* (Cf. the group of decisions of this Court cited in the footnote on p. 16, involving the "construction and validity" of the sections dealing with landlords' claims.)

who live in the country, in villages, in towns and cities. * * *" (p. 30 of 238 U. S.)

Cf. *Local Loan Co. v. Hunt,* 292 U. S. 234, at page 245 (1934).

This view has been echoed in the lower federal courts. In *In re Bockhaus,* 177 Fed. 141, C. C. A. 7 (1910), the court, pointing out that the Bankruptcy Act is "a national act" and was intended to eliminate as far as possible "the confusion and harassment attendant upon a multiplicity of variant local laws" used the following language:

> "* * * Therefore the act in all its parts ought to be interpreted in a national view, doing away as far as possible with the variances of the local laws. * * *" (p. 145, *ibid.*)

Midamerica submits that the foregoing interpretation of the act is sound and not in derogation of *Erie Railroad Co. v. Tompkins* and that the concept of state law under the doctrine of *Erie Railroad Co. v. Tompkins* should not be expanded in doubtful cases in such a way as to produce unnecessary confusion in the administration of a national act.

Midamerica points out, moreover, that such confusion, produced by the absence of clear principles of guidance, may frequently have the result in the various circuits—as was the fact here—of seriously delaying corporate reorganizations. Such a result is contrary to the intent of Congress that reorganizations be facilitated as much as possible. *Continental Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co. et al., supra,* at p. 685. Midamerica, therefore, urges that certiorari should here be granted to secure uniformity of decision in a field where uniformity is clearly desirable. *Magnum Import Co. v. Coty,* 262 U. S. 159 (1923).

2. If the Conflict with the Circuit Court of Appeals for the Second Circuit Relates to a Question Which is Controlled by State Law, the Decision Below is Probably Untenable and is in Conflict with the State Law.

If, despite the considerations outlined under subsections (i), (ii) and (iii) above, this Court should conclude that the conflict relates to a question controlled by state law, Midamerica submits, in the alternative, that certiorari should be granted because the decision below is "probably untenable" and "probably in conflict with the state law." (See language of Mr. Justice Reed at p. 206 of *Ruhlin v. New York Life Insurance Co., supra.*)

On the assumption that state law governs, it is clear that, under settled principles of the conflict of laws, the applicable law is either that of New York or of Ohio. New York is the state where the Morgan auction sale was held and where the Van Sweringens acted, or failed to act, in such a way as allegedly to involve themselves in a breach of fiduciary duty to the Debtor. See *Beale, The Conflict of Laws,* Vol. Two, §§ 377.2, 378.1 *et seq.* Ohio is the state of the Debtor's incorporation. See *Rogers v. Guaranty Trust Company of New York,* 288 U. S. 123 (1933).

If the law of New York governs, the decision below was clearly in conflict with that law as announced in *Tiffany v. Smith,* 124 N. Y. Sup. 85 (1910), being the only New York case on the subject. In *Tiffany v. Smith,* which was strongly relied on by petitioner below, directors who had guaranteed the obligations of their company were permitted to protect themselves upon a judicial sale of the Company's property by buying in the property for themselves, even though they had not discharged their guaranty.

If the law of Ohio governs, we are remitted to the entire body of substantive law on the question, for there is no relevant Ohio authority. There are, of course, general statements in Ohio cases regarding the duty of a director to his corporation, but opposing counsel have not cited—

and petitioner has been unable to find—any Ohio case in point on the issue here involved. Midamerica believes, however, that the decision below was probably in conflict with the Ohio law "as yet unannounced by the highest court of the state" (p. 206 of *Ruhlin v. New York Life Insurance Co., supra*) because that decision was so clearly opposed to the weight of authority.

Relevant decisions of this Court and of the lower federal courts plainly establish the right of a director to protect legitimately acquired interests and to avoid the personal loss and individual liability which would result from the denial of such right in cases where the director has advanced cash or lent credit to his company. These decisions are *Twin-Lick Oil Co. v. Marbury,* 91 U. S. 587 (1875); *Sanford Fork & Tool Co. v. Howe, Brown & Co.,* 157 U. S. 312 (1895); and *Arn v. Bradshaw Oil & Gas Co.,* 108 Fed. (2d) 125 (1940), all of which are analyzed fully under Reasons 3 and 4 below and which, therefore, in the interest of brevity are not discussed at length at this point.

3. The Decision Below Fails to Follow Applicable Decisions of this Court and of the Circuit Court of Appeals for the Fifth Circuit on an Important Question in the Law of Corporate Fiduciaries.

In *Twin-Lick Oil Company v. Marbury,* 91 U. S. 587 (1875), a director in good faith lent money to his corporation and took a mortgage on certain of its property to secure the loan. On default, he foreclosed the mortgage and bought in the property himself. This Court held that he was not accountable for profits later derived from this property; and since this decision, it has been settled law that a director of a corporation may in good faith lend money to it and that the debt thereby created and the security given therefor are valid and enforceable in his hands.

The Court stated from the premise that the loan itself was proper. It then reasoned as follows: (i) Since the

loan was valid, the director could properly take security. (ii) Since he could take the security, he had a right to enforce it. The case thus stands for the obviously fair doctrine that where a director, acting throughout in entire good faith, acquires valid rights against his company, he may take appropriate steps to protect those rights, and his action in so doing is not inconsistent with his duty of loyalty. Midamerica invokes this doctrine here.

Through personally guaranteeing the $16,000,000 Morgan loan to Vaness and the $23,500,000 loan to the Debtor, the Van Sweringens in good faith lent their credit to Vaness and to the Debtor. Because of these guaranties, the Van Sweringens not only risked the complete loss (a) of their investment in Vaness (to which they had made a capital contribution of nearly $15,000,000 and 80% of whose common stock they owned), and (b) of their investment in the Debtor, but also they pledged their personal resources to the extent of any deficiency which might result on foreclosure of the two Morgan loans aggregating $39,500,000.*

From the beginning, therefore, the Van Sweringens as guarantors were profoundly concerned with the aggregate value of all the pledged collateral. Their contingent liability rose and fell as its value fluctuated up and down, and finally became fixed when its value became fixed on the day of the public auction on September 30, 1935. The Van Sweringens' economic and equitable interest in the collateral was thus obvious and unquestioned and justified their attempt to minimize probable heavy loss by acquiring some share in it.

Their attempt, of course, failed. The Van Sweringens at the time of the auction were hopelessly insolvent, with

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* Vaness had also guaranteed the $23,500,000 Morgan loan to the Debtor, and consequently all the assets of Vaness, as well as all the personal credit of the Van Sweringens, were back of both loans. (R. 124, 243, 263.)

relatively small assets and with liabilities (arising mainly from guaranties of debts of their companies) which totalled more than $50,000,000. (R. 132.) M. J. Van Sweringen died within two months, owing $68,000,000. (R. 132.) O. P. Van Sweringen died within a year and two months, owing $80,000,000. (R. 133.) They had not, and could not have, exercised the option. But the very hopelessness of their endeavors to save themselves from total ruin shows how plainly the court below disregarded the record in concluding that the Van Sweringens somehow made a profit from Midamerica.

Until the Van Sweringens had discharged their guaranties, they could make no profit from Midamerica, and, indeed, they had no reasonable possibility of making such a profit at any time. Certainly they made no profit from their option, which was never exercised because it could only be exercised after the payment or adjustment of all their debts, including their guaranties. Certainly they made no profit from a drawing account which was given as compensation for management of the valuable railroad properties, which has never been attacked as unreasonable, and which would have been precisely the same irrespective of Midamerica's acquisition of the Debtor's bonds. Consequently, *Magruder v. Drury*, 235 U. S. 106 (1914), and *Jackson v. Smith*, 254 U. S. 586 (1921), holding that a fiduciary and his associates are liable for profits realized from their dealings with the beneficiary, are irrelevant, and the reliance of the court below on these cases was error.

The court below dismissed the entire foregoing argument in one paragraph, citing an Ohio case which did not even involve a guaranty.

> "From the premise that the *Twin-Lick Oil Company* case, *supra*, establishes the right of a director to protect a validly acquired interest as against his corporation, appellant earnestly insists that it should prevail

in these suits. We cannot concur. The mere fact that the Van Sweringens were endorsers and guarantors of heavy obligations of the corporations in which they were directors does not avoid the effect of the doctrine that they should not be permitted, directly or indirectly, to derive from their position personal profit or advantage not shared by all stockholders. See *Thomas v. Matthews*, 94 O. S. 32, 43."

Twin-Lick Oil Company v. Marbury, supra, clearly demonstrates the incorrectness of this view, because the very basis of this decision is that a director who has lent his credit to his company acquires by virtue of that fact important contract and property rights which otherwise he would not possess. *Twin-Lick Oil Company v. Marbury* was cited with approval in *Allen v. Gillette*, 127 U. S. 589 (1888), and in *Starkweather v. Jenner*, 216 U. S. 524 (1910), to sustain the proposition that even an express trustee may purchase trust property at a judicial sale which he has taken no part in procuring and over which he had no control.

Moreover, the Circuit Court of Appeals for the Fifth Circuit in a recent decision relies in part upon the doctrine of *Twin-Lick Oil Company v. Marbury* to sustain a purchase of corporate property against the charge of breach of fiduciary duty. The case is *Arn v. Bradshaw Oil & Gas Co.*, 108 Fed. (2d) 125 (1940), cert. den., 310 U. S. 646. Here a bank holding a first mortgage given by an oil company foreclosed the mortgage and bid in the property at judicial sale. A few days later, by a separate and independent transaction, it resold the property to the Bradshaw Company, which had been formed for this purpose by a group of second-lien creditors of the oil company. Bradshaw, who was president of the new company, had been a director of the oil company and had formerly been associated with one of the largest second-lien creditors. Boyd, who owned a stock interest in the new company, had also been a director of the oil company and continued

to be associated with another second-lien creditor. Stockholders of the oil company contended that the position of Bradshaw and Boyd resulted in a violation of their fiduciary duty to the oil company.

The court held to the contrary, citing as one of three relevant decisions by this Court, *Twin-Lick Oil Company v. Marbury, supra.** Among the facts emphasized in the opinion are three in which the *Arn* case closely resembles the case at bar: (a) all the directors of the oil company "did their best" for the oil company prior to the sale (p. 127 of 108 Fed. (2d)); (b) none of the directors of the oil company brought about the foreclosure sale or contributed to it (p. 127, *ibid*); (c) the purchase by the second-lien creditors in order "to recover if possible" their debts against the oil company was not an abuse by the directors of their office (p. 128, *ibid*).

Thus *Twin-Lick Oil Company v. Marbury,* as interpreted by later decisions of this Court and by at least one Circuit Court of Appeals, stands for the principle (in no way inconsistent with a director's duty of loyalty to his corporation) that a director may protect validly acquired rights. Unless this principle is to be narrowly confined to the simple case of a cash loan and sternly rejected in the case of a credit loan, it should govern here.

If the Van Sweringens had been financially able to pay the loan to Vaness and the Debtor and so discharge their guaranties, they would have acquired indefeasible rights in the pledged collateral.** In equity the Van Sweringens, because they continued to remain liable on their guaranties, stand in the same position *with respect to this Debtor* as if they had paid the loan.

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* The other two cases cited are *Michaud v. Girod*, 4 How. 503 (1845) and *Stephen v. Beall*, 22 Wall. 329 (1874).

** *Leavenworth County Comm'rs v. C. R. I. & P. Ry.*, 134 U. S. 688 (1890); *Sanford Fork & Tool Company v. Howe, Brown & Company*, 157 U. S. 312 (1895); *Fitzgerald and Mallory Construction Co. v. Fitzgerald*, 137 U. S. 98 (1890).

As this Court said in the *Twin-Lick Oil Company* case:

> "Defendant was at liberty to bid, subject to those rules of fairness which we have already conceded to belong to his peculiar position; for, if he could not bid, he would have been deprived of the only means which his contract gave him of making his debt out of the security on which he had loaned his money." (pp. 590-591 of 91 U. S.)

So here, to deny the Van Sweringens the right to buy the Debtor's bonds at a free, open and public sale would be to deprive them of their only means of reducing their deficiency liability as guarantors and would nullify in large measure the right of a guarantor or surety to look for protection to the collateral pledged by the principal obligor.

4. The Decision Below, by an Overzealous Application of Pepper v. Litton, 308 U. S. 295, Ignores Well-Settled Principles of Equity as Declared by this Court and, in Fact, Undermines a Director's Duty of Loyalty.

Although the evident purpose of the opinion below is to enforce vigorously a director's duty of loyalty to his corporation in accordance with the recent enunciation of this well-settled duty in *Pepper v. Litton, supra*, the effect of the opinion will be precisely the opposite. The decision, if allowed to stand, will tend to have a widespread, undesirable influence on the attitude of corporate directors because of the very extremes to which it goes and because of the changed judicial attitude which it evidences toward directors who have pledged their entire personal resources for their corporation.

In *Sanford Fork & Tool Company v. Howe, Brown & Company*, 157 U. S. 312 (1895)* this Court clearly con-

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* The *Sanford* case was cited to the court below as one of 16 decisions (collected in the appendix to Midamerica's main brief below) which involved guaranties by a fiduciary and in which the fiduciary's purchase of corporate property or debt was upheld. The *Sanford* case was followed in *Geisenberger & Friedler et al. v. Robert York & Co. et al.*, 262 F. 739 (C. C. A. 5, 1919) and *In re Federal Coal Co.*, 31 F. (2) 375 (1927).

firmed the right of a director-guarantor to protect himself against loss upon his guaranty. In that case the Court had under consideration the validity of a mortgage given by a corporation while insolvent, although still a going concern, in order to protect its directors from liability on account of their personal guaranty of the corporation's notes. In the course of its opinion this Court made the following observation, which is especially pertinent to the circumstances under which the Van Sweringens executed the guaranties here involved:

"* * * The mortgage was not given simply as security for a past indebtedness, but to induce the indorsers to obtain for the corporation a renewal or extension of its obligations, and to make further indorsements. In reliance upon this mortgage the indorsers secured renewals or extensions, or themselves took up the notes they had indorsed, and at the same time lent the credit of their names to new paper of the company. *Thus they prevented a suspension of the business and enabled the corporation to continue its operations, and did so believing that by such continuance the corporation would be enabled to work itself out of its temporary difficulties. All this was done in the utmost good faith.*" (pp. 316, 317 of 157 U. S.)

* * * * *

"We are of opinion that these facts clearly and fully distinguish this case from many which have been cited, in which the action of the directors of a corporation in securing to themselves preferences in the hour of its extremities has been adjudged void, *and that it is going too far to hold that a corporation may not give a mortgage to its directors who have lent their credit to it, to induce a continuance of the loan of that credit, and obtain renewals of maturing paper at a time when the corporation, though not in fact possessed of assets equal to its indebtedness, is a going concern, and is intending and expecting to continue in business.* We are, therefore, of opinion that the Circuit Court erred, * * *." (p. 320, *ibid.*) (Emphasis supplied.)

Under this decision the Van Sweringens would have been entitled, for their own protection, to take a second mortgage on the Vaness and Debtor assets pledged with Morgan. Under this decision the Van Sweringens, in guaranteeing the loans to Vaness and the Debtor, unquestionably acted in good faith. Yet the court below found that "bad faith and breach of fiduciary duty were implicit" in the purchase by the Van Sweringens of the collateral securing the guaranteed loans and further held that the Van Sweringens were not entitled, as "endorsers and guarantors of heavy obligations" of their corporations, to protect themselves against liability. (R. 303, 309.)

If the opinion below is allowed to stand, directors will know that in the Sixth Circuit their duty of loyalty is a dangerous duty. They will know that they act at their peril in pledging their personal credit on behalf of their companies—however urgent the need and however wise the pledge from a business standpoint. They will know that although previously courts have encouraged a director's willingness to risk his own resources for the sake of the corporate enterprise,* today this outlook no longer prevails. They will know finally that all fiduciaries are lumped indiscriminately into one large class; that the right to protect a legitimate interest (which is the underlying theme of *Twin-Lick Oil Co. v. Marbury, Sanford Fork & Tool Company v. Howe, Brown & Company,* and *In re New York Railways Corp.,* all *supra*) is no longer extended to corporate directors; and that a rule which in equity and fairness has previously been applied only to profit-seeking volunteers (having no pre-existing interest to protect) is now applied even to directors who, because of their position as guarantors or sureties, seek simply to reduce overwhelming losses and to minimize enormous liabilities.

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* As the court said in *Arn v. Operators Royalty & Producing Co.*, 13 Fed. Supp. 769, 773 (1936), an officer who has made a loan in good faith "* * * should be commended rather than condemned for the action * * *."

CONCLUSION.

It is respectfully submitted that this Court should grant Midamerica's petition for a writ of certiorari in order (a) to resolve a conflict of decision between the Circuit Courts of Appeals of the Second and Sixth Circuits on a matter of importance in the administration of the Bankruptcy Act, or, in the alternative, to resolve a conflict between the decision below and the applicable state law, and (b) to remove the doubt, confusion and uncertainty which have been engendered in the law of corporate fiduciaries through overzealous application by the court below of *Pepper v. Litton* and its failure to follow the equitable principles laid down in *Twin-Lick Oil Co. v. Marbury, Sanford Fork & Tool Company v. Howe, Brown & Company,* and *Arn v. Bradshaw Oil & Gas Co.*

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APPENDIX A.

GROUP 1.

	Security Purchased	Individual Parcel Bid	Market Value[1]
1.	100,000 shares of common stock of Alleghany Corporation	$ 50,000	$ 137,500
2.	"	40,000	137,500
3.	"	30,000	137,500
4.	"	20,000	137,500
5.	"	10,000	137,500
6.	"	12,914	177,556
7.	6,915 shares of preferred stock, Series A, of Alleghany Corporation	28,933	34,011
8.	10,000 shares of the capital stock of Cleveland Railway Company	598,800	640,000
9.	"	598,800	640,000
10.	"	598,800	640,000
11.	10,393 shares of the capital stock of Cleveland Railway Company	622,540	665,152
12.	250 shares of the capital stock of Huron-Fourth Company	1,250	no market value
13.	196 shares of the capital stock of The Long Lake Company	none	no market value
14.	17,000 shares of the capital stock of Terminal Building Company	none	no market value
15.	122,000 shares of the common stock of the Debtor	none	no market value
16.	1,244,580 shares of the common stock of Van Sweringen Corporation	none	no market value
17.	$139,000 certificates of deposit representing bonds of Alleghany Corporation	29,885	31,970
18.	*$270,000 second mortgage bonds of The Cleveland Terminals Building Company*	*none*	*no market value*
19.	$817,460.36 demand notes of The Long Lake Company	25,000	no market value
20.	$278,204.84 demand notes of Metropolitan Utilities, Inc.	none	no market value
21.	$207,176.60 demand notes of Terminal Building Company	none	no market value
22.	$170,430.29 demand note of The Terminal Hotels Company	none	no market value
23.	$6,261,697.59 demand notes of The Van Sweringen Company	none	no market value
24.	$13,787,000 gold notes of the Debtor	none	no market value
25.	$554,103 demand notes of Van Sweringen Corporation	none	no market value
26.	$2,595,398.85 subordinated note of Van Sweringen Corporation	none	no market value
27.	$1,292,534.72 subordinated note of The Higbee Company	83,333	no market value
28.	$69,673.71 participation in $523,043.51 note of The Higbee Company	52,256	no market value

[1] Computed on the basis of the lowest sale price on September 30, 1935, or, if there were no such sale, the bid price on that date on the exchange (New York or Cleveland) on which the security was listed. Petitioner recognizes, of course, that the Alleghany, Cleveland Railway, and Pittston securities could not have been sold in large blocks at the prices indicated.

GROUP 3.

	Security Purchased	Individual Parcel Bid	Market Value
33.	100,000 shares of the common stock of Alleghany Corporation	$ 10,000	$ 137,500
34.	"	10,000	137,500
35.	"	10,000	137,500
36.	"	10,000	137,500
37.	"	10,000	137,500
38.	"	10,000	137,500
39.	"	10,000	137,500
40.	"	10,000	137,500
41.	"	5,000	137,500
42.	100,000 shares of the common stock of Alleghany Corporation	5,000	137,500
43.	"	5,000	137,500
44.	"	5,000	137,500
45.	"	5,000	137,500
46.	135,360 shares of the common stock of Alleghany Corporation	6,768	186,120
47.	27,635 shares of the preferred stock, Series A, of Alleghany Corporation	120,337	136,860
48.	100,000 shares of the common stock of The Higbee Company	200	no market value
49.	33,859 shares of the common stock of Pittston Company	none	46,556
50.	$317,000 certificates of deposit representing bonds of Alleghany Corporation	68,155	72,910
51.	*$930,000 second mortgage bonds of The Cleveland Terminals Building Company*	*none*	*no market value*
52.	$258,506.94 subordinated note of The Higbee Company	16,667	no market value
	TOTAL	$3,119,229	$5,746,135 [1]

[1] A less detailed summary of indicated market value, showing a total of $5,745,219, appears at R. 152.

APPENDIX B.

11 U. S. C. A. § 602. *Rejection of executory contract or unexpired lease; assignment of future rent claim.*

In case an executory contract shall be rejected pursuant to the provisions of a plan or to the permission of the court given in a proceeding under this chapter, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity in a prior pending proceeding, any person injured by such rejection shall, for the purposes of this chapter and of the plan, its acceptance and confirmation, be deemed a creditor. The claim of the landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be provable, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by such lease for the three years next succeeding the date of the surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid accrued rent, without acceleration, up to such date of surrender or reentry: *Provided,* That the court shall scrutinize the circumstances of an assignment of a future rent claim and the amount of consideration paid for such assignment in determining the amount of damages allowed the assignee thereof. July 1, 1898, c. 541, § 202, as added June 22, 1938, c. 575, § 1, 52 Stat. 893.

11 U. S. C. A. § 612. *Same; regulation by court.*

The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor. July 1, 1898, c. 541, § 212, as added June 22, 1938, c. 575, § 1, 52 Stat. 895.

(23)

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FILED
OCT 3 1941
CHARLES ELMORE CROPLEY
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. 614.

IN THE MATTER OF
VAN SWERINGEN CORPORATION, Debtor,
and
THE CLEVELAND TERMINALS BUILDING COMPANY,
Subsidiary Debtor.

THE TERMINAL AND SHAKER HEIGHTS
REALTY COMPANY
(formerly Midamerica Corporation),
Petitioner,

vs.

THE CLEVELAND TERMINALS BUILDING COMPANY,
Respondent.
(A. B. GOCHENOUR, *et al., Intervenors.*)

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SIXTH CIRCUIT.

BRIEF OF RESPONDENT IN OPPOSITION TO THE PETITION.

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THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO

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ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SIXTH CIRCUIT.

BRIEF OF RESPONDENT IN OPPOSITION TO THE PETITION.

The Terminal and Shaker Heights Realty Company (formerly named "Midamerica Corporation" and hereinafter referred to as "Midamerica") has filed herein its petition and supporting brief, praying that a writ of certiorari be issued to review an order of the Circuit Court of Appeals for the Sixth Circuit entered in this cause on

April 16, 1941. Said order affirmed an order of the District Court for the Northern District of Ohio, Eastern Division, allowing for $2.00 only a claim by Midamerica against The Cleveland Terminals Building Company (hereinafter called the "Debtor") on the Debtor's Second Mortgage Bonds in the principal amount of $1,200,000. Midamerica's petition for a rehearing was denied by said Circuit Court of Appeals on June 25, 1941 (R. 323).

QUESTION PRESENTED.

The question presented is whether Midamerica should be allowed to prove for $1,348,614.99 (full principal and interest) a claim on Second Mortgage Bonds of the Debtor in the principal amount of $1,200,000., which Midamerica purchased for $2.00, or whether Midamerica's recovery on said claim should be limited to the amount it paid for said Bonds, plus interest thereon, in view of the fact Midamerica was an instrumentality used by the controlling directors of the Debtor and their associates to purchase said Bonds for themselves at a small fraction of their face amount while the Debtor was insolvent.

STATEMENT.

The Debtor is an Ohio corporation. On October 31, 1930, and at all times thereafter down to September 30, 1935, O. P. and M. J. Van Sweringen and C. L. Bradley were three of the five directors of the Debtor, and C. L. Bradley was the President and M. J. Van Sweringen was the Vice President of the Debtor (R. 45-46; Exhibit K, offered at R. 31). During all of said period, all of the capital stock of the Debtor was owned by Van Sweringen Corporation, a majority of the voting stock of Van Sweringen Corporation was owned by Vaness Company (hereinafter called "Vaness"), and 90% of the voting stock of Vaness was owned by the Van Sweringens and Bradley (R. 30-31).

On October 31, 1930, the Debtor borrowed from J. P. Morgan & Company (hereinafter called "Morgan") $23,500,000. and on the same date Vaness borrowed from Morgan $16,000,000. (R. 31). The Van Sweringens personally guaranteed payment of said two loans aggregating $39,500,000. (R. 121-122), but never paid anything on their guaranties. Prior to September 30, 1935 (the date of the auction sale hereinafter mentioned), $930,000. of the Bonds on which Petitioner's claim is based were owned by the Debtor and pledged with Morgan as security for said $23,500,000. loan of the Debtor, and the remaining $270,000. of said Bonds were the property of Vaness and pledged with Morgan as security for said $16,000,000. loan to Vaness (R. 34).

The notes evidencing said two loans to the Debtor and Vaness matured on May 1, 1935. On or about that date, a letter was delivered to Morgan, signed on behalf of The Cleveland Terminals Building Company by Bradley, President, and John P. Murphy, Secretary, on behalf of Vaness by O. P. Van Sweringen, President, and John P. Murphy, Assistant Secretary, and signed personally by O. P. Van Sweringen and M. J. Van Sweringen, representing and admitting that said parties and each of them were unable to pay said notes in whole or in part other than by resort to the sale of the collateral securities pledged to secure the same, and waiving notice of protest or non-payment of said notes, and also waiving notice of any sale of the collateral held for said notes because of the default in the payment of the principal and interest upon said notes (R. 126-127; Exhibit A, offered at R. 122).

Between May 1, 1935 and August 1935 the Van Sweringens made numerous efforts to raise capital with which to rescue the securities representing control of the so-called "Van Sweringen Empire" which were pledged with Morgan, on a basis which would preserve to them control of the said Empire and a major share of the profits which

might accrue from increased value and earning capacity of said securities and the enterprises which they represented (R. 197-8, 216-220). In August they worked out an arrangement for such financing with George A. Ball of Muncie, Indiana and G. A. Tomlinson of Cleveland, Ohio (R. 34-35), which was finally set forth in a letter from Ball and Tomlinson to the Van Sweringens dated September 21, 1935 (R. 60; Exhibit S, offered at R. 35). This letter agreement, though signed by Ball and Tomlinson, was drawn by the Van Sweringens' attorneys (R. 35). The letter agreement (Exhibit S, R. 60) provided for the organization of Midamerica, the purchase of 20,000 shares of its first preferred stock for $2,000,000. and 15,000 shares of its common stock for $15,000. by Ball and Tomlinson, a Board of six Directors of whom the Van Sweringens and Bradley would be three, a ten year option to the Van Sweringens to purchase 55% of the common stock from Ball and Tomlinson at their cost of $8,250. plus 5% interest per annum, and for a sole and exclusive right in the Van Sweringens to vote the common stock which was subject to the option during the ten year period of the option. Said agreement further provided that the option should be exercisable by the Van Sweringens only after they should have satisfied at least five of the six directors of Midamerica Corporation that they had paid or adjusted any and all claims based upon their then existing commitments or relationships that might then or thereafter become enforceable against them (R. 60-62). It was also agreed, though not specified in said letter agreement, that O. P. and M. J. Van Sweringen should be paid at the rate of $100,000. per year for the services to be rendered by them over the ten year period (R. 257, 279-280).

The organization of Midamerica Corporation was completed in accordance with the agreement of September 21, 1935, with the Van Sweringens and Bradley as three of the six directors, O. P. Van Sweringen as President, M. J.

Van Sweringen and Bradley as Vice Presidents and the remaining offices (other than three directorships) all held by Van Sweringen employees (R. 35-36). Midamerica Corporation then bid for certain Van Sweringen securities at the Morgan auction sale on September 30, 1935 and purchased at that sale, among other things, the Bonds which are the basis of Petitioner's claim. The securities purchased were in two groups and the distribution of the price paid for each group among the different securities which made up the group was not specifically provided for in the bid (R. 37-38). The price so paid was, however, distributed among the different items on the books of Midamerica on the basis of allocating to the securities for which separate bids had been made, the amounts of those separate bids, respectively, and allocating to the securities for which no separate bids had been made, the (relatively nominal) amount of the group bid over the aggregate of separate bids for items included in the group (R. 92-96; Exhibits Y, Z, Z-1 and Z-2, offered at R. 38). The amount, so allocated on the books of Midamerica to the Bonds of the Debtor on which Petitioner's claim is based, was $2.00. The market prices on the date of the sale of the listed securities alone included in the two groups purchased aggregated $5,745,-219.63 (R. 39 and 307). The bid prices totaled $3,121,000 (R. 37-38).

Prior to the Morgan auction sale on September 30, 1935 there had been various discussions between Morgan and the Van Sweringens as to the method of sale and it was not until Morgan had been advised that the Van Sweringens had made arrangements for financing which would make possible a bid by an entity in which the Van Sweringens would be interested, that definite arrangements for a sale were made (R. 177, 203; Exhibit 9, offered at R. 146). Notice of the sale to be held on September 30, 1935 was first given to the general public by publication in various newspapers on September 13, 1935 (R. 52, 59; Exhibit R, offered at R. 25).

No claim is made that the Van Sweringens ever notified the Debtor, or the numerous creditors of the Debtor other than Morgan, of the proposed auction sale, or of the existence or terms of the letter agreement of September 21, 1935, or of the fact that they would be interested on the side of a prospective purchaser at the sale, and so disqualified to represent the interests of the Debtor and its creditors at the sale. Nor did they or Midamerica ever offer the Debtor any opportunity to acquire the bonds which constitute the basis for the claim of Midamerica against the Debtor here involved (R. 40).

The Circuit Court of Appeals found that Midamerica was a combination in corporate form participated in by directors of the Debtor, formed and utilized for the purpose, among other things, of obtaining claims against the Debtor at a sacrifice for the profit of the combination at the expense and to the detriment of the Debtor; that the Debtor was insolvent on the date of the auction sale; that bad faith and breach of fiduciary duty were implicit in the purchases by officers of the company of the corporate securities at the auction sale; and that Midamerica acquired and holds the bonds on which its claim is based as trustee for the Debtor and is entitled to allowance of its claim only in the amount paid for the same, which on the basis of Midamerica's own allocation of the group prices paid at the auction sale must be held to have been $2.00, together with interest thereon (R. 302-303). In so finding the Circuit Court of Appeals adopted the findings of the District Court which had in turn adopted the findings of the Special Master (R. 98, 262, 302-3). The Debtor was insolvent on September 30, 1935, having liabilities far in excess of its assets even if the latter were taken at their book values (R. 85). It had free cash balances then and thereafter which might have been used to acquire its bonds if an opportunity had been given to it to acquire them at bargain prices (R. 41).

ARGUMENT.

For the purposes of the Petition for a Writ of Certiorari, Petitioner admits that it is in no better position than the Van Sweringens would be if they had personally purchased the claim here involved (Petition, page 3, footnote), and we shall therefore discuss the questions raised on that assumption.

1. THE DECISION BELOW IS NOT IN CONFLICT WITH THE DECISION OF THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT IN IN RE NEW YORK RAILWAYS CORPORATION, 82 FED. (2d) 739 (C. C. A. 2, 1936).

As the first of its reasons for granting the writ, Petitioner states that the decision below is in conflict with a decision of the Circuit Court of Appeals for the 2nd Circuit on a matter of importance in the administration of the Bankruptcy Act and refers in that connection to the case of *In re New York Railways Corporation,* 82 Fed. (2d) 739 (C. C. A. 2, 1936), Cert. Den. under the name of *Brukenfeld et al. v. New York Railways Corporation et al.,* 298 U. S. 687 (1936). This case involved the enforceability by the Fifth Avenue Coach Company, for the full amount of principal and interest due thereon, of bonds of its subsidiary, the New York Railways Corporation, then in reorganization under Section 77 B of the Bankruptcy Act, which it had purchased at a discount.

Petitioner attempts to draw a parallel between the facts in the *New York Railways* case and the facts in the case at bar. Petitioner admits that the court in the *New York Railways Corporation* case found that the Board of the Debtor was independent and that there was no ground to infer from its inaction any improper influence by the parent (Petitioner's Brief, p. 14). The court below found the facts in our case to be quite otherwise in respect of this controlling matter. In fact counsel for the Petitioner admits that "the Van Sweringens undoubtedly controlled the

Debtor'' in our case (Petitioner's Brief, p. 14). The court in the *New York Railways* case said at page 741:

> "The Fifth Avenue Coach Company had not so usurped the management of the debtor that the Board of Directors were influenced to inaction and silence on any plan for the debtor itself to buy in its income bonds at a low figure."

Although the court did then say that the failure of the debtor to so act was undoubtedly due to its financial inability rather than to any fiduciary faithlessness, it went on to discuss a theory on which that might not have been so and to indicate that this consideration was not controlling. On page 742, the court said:

> "However, no matter how able the debtor was to buy the income bonds for itself, there is nothing to show, and no ground to infer, that its inaction in this respect was due to the Fifth Avenue Coach Company's control. During this period, its Board had a majority of independent directors free to act without being influenced by any allegiance to the Fifth Avenue Coach Company. The mere fact that the debtor could have made the purchase does not render the stockholders' purchase voidable."

In our case the Van Sweringens not only dominated the Debtor through stock ownership, but they and Bradley, who was also associated with them in the purchasing corporation, constituted three of the five members of the Board of Directors of the Debtor and Bradley was President and M. J. Van Sweringen Vice President of the Debtor at the time the Debtor's bonds were purchased by Midamerica. Our case presents a situation in which there was undoubtedly no independent Board of Directors which could act in the interests of the Debtor. A majority of the Board as well as the chief executive officers of the Debtor had gone over to the side of the purchaser and left the Debtor without representation.

No claim of a conflict on a matter of law of importance in the administration of the Bankruptcy Act can be based upon the fact that the Circuit Court of Appeals for the 2nd Circuit allowed a claim to be proved in full where the purchaser did not dominate the Debtor at the time of the sale and the Circuit Court of Appeals for the 6th Circuit in our case has limited recovery to the amount of the claimant's investment, with interest, where parties associated in interest with the claimant "undoubtedly controlled the Debtor" (Petitioner's Brief, p. 14) at the time the claim against the Debtor was purchased.

It will serve no useful purpose to enter here into a discussion of the evidentiary facts in the *New York Railways Corporation* case, as Petitioner attempts to do in an effort to show that the court in that case was not justified in finding that the Debtor's Board was independent and that the purchaser of the claim against the Debtor did not dominate the management of the Debtor at the time of purchase. That is a question of fact on which there can be no justification for going back of the findings of the court. Petitioner's argument comes down to this, that the Circuit Court of Appeals for the 2nd Circuit found as a fact that there was no domination and control of the Debtor under circumstances which Petitioner feels might have justified a finding that there was such domination and control, although Petitioner does not even claim that the evidence of domination and control was as strong as in our case. Surely, this Court will not grant a petition for a writ of certiorari to remedy such an alleged conflict.

2. THE DECISION BELOW IS NOT IN CONFLICT WITH THE STATE LAW OF NEW YORK OR OHIO.

Petitioner's argument that if the conflict with the Circuit Court of Appeals for the 2nd Circuit relates to a question which is controlled by state law, the decision below is probably untenable and is in conflict with the state law is also without foundation, not only because, as shown above,

there is no conflict between the legal doctrines announced by the Circuit Court of Appeals for the 2nd Circuit and the doctrines announced by the Circuit Court of Appeals for the 6th Circuit in our case, but also because there is no conflict between the latter and any applicable state law.

If the question involved is controlled by state law, the applicable law would, as Petitioner says, apparently be either that of New York where the Morgan auction sale was held, or that of Ohio which is the state of the Debtor's incorporation.

Petitioner admits that it has not been able to find any Ohio law which it even claims is in conflict with the decision of the Circuit Court of Appeals in our case. While we have not found in any reported Ohio case a factual situation similar to that in the case at bar, we think the general principles applicable are well stated by the Ohio Supreme Court in the case of *Thomas v. Matthews*, 94 O. S. 32 (1916), where the court says at page 43:

> "It is the settled law of this state that directors must manage the corporate business with a view solely to the common interest, and cannot directly or indirectly derive personal profit or advantage from their position which is not shared by all the stockholders.
>
> The maxim, *uberrima fides*, of the civil law applies without limitation or restriction to their relation to the corporate property and business. They occupy a strictly fiduciary relation to the stockholders and are accountable to them on principles governing that relationship. *Rouse, Trustee, v. Merchants' National Bank*, 46 Ohio St., 493, 502; *Larwill v. Burke et al.*, 66 Ohio St., 683, affirming *Larwill v. Burke et al.*, 19 O. C. C., 449; *Peter v. The Union Mfg. Co. et al.*, 56 Ohio St., 181; *Greenville Gas Co. v. Reis et al.*, 54 Ohio St. 549, 558; *Elliott on Private Corporations* (4 ed.), Sections 502, 503; 8 *Thompson on Corporations* (2 ed.), Sections 1215, 1216; *Warren v. Para Rubber Shoe Co.*, 166 Mass. 97, 104, and 1 *Morawetz on Private Corporations* (2 ed.), Section 517."

Petitioner refers to the case of *Tiffany vs. Smith*, 124 N. Y. Supp. 85 (1910), as the only New York case on the subject. That case, if it be the New York law, is not in conflict with the decision of the Circuit Court of Appeals in our case because there were controlling considerations in that case, not present in our case, which justified the conclusion that the purchaser was not a trustee for the Debtor corporation. The report shows that the case of *Tiffany vs. Smith* was a case for an accounting, brought five and a half years after the sale, that before the purchase was made the company had been dissolved, a receiver had been appointed and the Director's fiduciary duty had therefore been terminated, and that the Director bid in order to compel the banks and other bidders to give a fair price. Moreover, the plaintiff had been guilty of laches as indicated in syllabus 4, which reads in part as follows:

> "4. * * * This transaction (the fiduciary's purchase) having been carried out, defendants invested a large sum in the improvement of the business and property of the corporation without any claim on behalf of plaintiff or the other stockholders to interest therein until five and one-half years thereafter, when on January 24, 1903, plaintiff, a former stockholder, sued to declare a trust of the assets and business of the corporation for the benefit of the old stockholders. *Held*, that the plaintiff's right to relief was barred by laches."

The case therefore cannot be cited as authority for the proposition that a purchase by a director-guarantor would be upheld though he had paid nothing, if he were still at the time of the purchase primarily charged with the duties of a liquidating fiduciary of an insolvent corporation, as were the Van Sweringens, and if the complaint was timely, as here, instead of being barred by laches.

In the case of *Meinhard vs. Salmon*, 249 N. Y., 458 (1928), Judge Cardozo, speaking for the highest court in the State of New York, said at page 464:

> "Many forms of conduct permissible in a workaday world for those acting at arms length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exception. * * * Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court."

Discussion of the authorities cited by Petitioner from other jurisdictions than New York and Ohio is reserved for a later portion of this brief.

3. THE DECISION BELOW IS NOT INCONSISTENT WITH APPLICABLE DECISIONS OF THIS COURT OR OF THE CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT ON THE QUESTION OF RESPONSIBILITY OF CORPORATE FIDUCIARIES, BUT FOLLOWS THOSE DECISIONS.

The Petitioner discusses at some length the cases of *Twin-Lick Oil Co. vs. Marbury,* 91 U. S. 587 (1875) and *Arn v. Bradshaw Oil & Gas Co.,* 108 Fed. (2d) 125 (C. C. A. 5, 1940) and argues that the decision below fails to follow the principles laid down in those cases. In our view the decision below not only is not inconsistent with those cases but correctly applies the principles laid down in them.

In *Twin-Lick Oil Co. vs. Marbury, supra,* a director had in good faith loaned money to his corporation and taken a mortgage on certain of its property to secure the loan. On default, he foreclosed the mortgage and bought in the property. The court held that he was not accountable for profits later derived from the property so purchased. This conclusion was reached because of the ex-

istence of circumstances which were not present in our case, including the facts that the purchase was made at a fair price after adequate notice to the other parties to whom the director had a fiduciary relationship and after those other parties had refused to join the director in the purchase. It further appeared that, as stated in the third paragraph of the syllabus,

> "it was nearly four years thereafter, when the hazard was over, and his skill, energy and money had made his investment profitable, that any claim to, or assertion of right in, the property was made by the corporation or the stockholders."

In discussing the general principles applicable to a director's right to acquire and enforce claims against his corporation, the court said at page 590:

> "So, when the lender is a director, charged, with others, with the control and management of the affairs of the corporation, representing in this regard the aggregated interest of all the stockholders, his obligation, if he becomes a party to a contract with the company, to candor and fair dealing, is increased in the precise degree that his representative character has given him *power and control* derived from the confidence reposed in him by the stockholders who appointed him their agent. If he should be a sole director, or one of a smaller number vested with certain powers, *this obligation would be still stronger,* and his acts subject to more severe scrutiny, and their validity determined by more rigid principles of morality, and freedom from motives of selfishness." (Emphasis ours.)

In our case there is no doubt that the Van Sweringens and Bradley, who participated in the formation of the purchaser corporation, dominated the Debtor, constituting a majority of its Board and its chief executive officers, and that they took no means whatsoever to insure independent representation of the interests of the Debtor and its credi-

tors, but abandoned the Debtor without notice when they went over to the adverse position of purchasers.

In the case of *Arn v. Bradshaw Oil & Gas Co., supra,* a bank, holding a first mortgage given by an Oil Company, had foreclosed the mortgage and bid in the property at a judicial sale. A few days later, by a separate and independent transaction, it resold the property to the Bradshaw Company, which had been formed for the purpose of purchasing it by a group of second lien creditors of the Oil Company. Bradshaw, who was President of the new company, and Boyd, who owned a stock interest in the new company, had been directors of the Oil Company. The stockholders of the Oil Company attempted to have the sale set aside, or, alternatively, to declare the title held in trust for them. Their complaint was denied. The reason for the decision is set forth on page 127 as follows:

> "We shall not review the evidence. It clearly supports the conclusion that all the directors did their best by the Operators Company prior to the sale. Counsel for appellant mainly argues that the respondents Bradshaw and Boyd, being still directors at and after the sale, were bound formally to notify the stockholders that the property had been sacrificed by the sale but could be redeemed from the Bank at a low figure; and that the redemption which was in fact accomplished by these directors inures in equity to the benefit of the Operators Company. We recognize that directors are as respects their corporation and its stockholders quasi trustees, and that they are not allowed to obtain or retain any personal advantage due to a misuse of their position. The application of the principle here fails, because the directors did not misuse their position to obtain the challenged result, and because they have not personally obtained the property of their company.
>
> Kendall, who represented the Bank on the executive committee of Operators Company, resigned when the mortgage was foreclosed and long before the sale. Bradshaw, who was made director and put on

the committee as representing International Supply Company, which had the largest second lien of $160,000., resigned his connection with International and surrendered his stock in that company long before the sale. He testifies he resigned also as director in Operators Company and ceased to act as such as early as July, 1933, when the bankruptcy receiver took charge of the Company's offices and books; but there is some evidence to the contrary. Boyd, who actually superintended the wells, testifies he ceased to act as director, as did all the others, when the receiver appeared, though the receiver did not take over the wells, because the State court had them under foreclosure, and that, after July, 1933, he was paid a salary by the Bank for his services in superintending them. The corporation, before and after the sale, was actively represented by its receiver, and additionally in its own name by its counsel employed presumably by the President Dunnett, and these stockholders had their present counsel on the ground and appearing for the receiver. These all applied to the State court for further delay of the sale, which was denied. They opposed confirmation of it both on the ground that the property had sold too cheap and that the collusion above referred to existed. Confirmation was ordered. The Court of Civil Appeals refused to interfere. It is very plain that the sale was not the sale of the directors or any of them but was the sale of the court. No director had brought it about or contributed to it. The stockholders knew all about it through their counsel, just as the corporation knew about it through its counsel, its receiver and its President who was present at the sale. All parties had the same opportunity to purchase the property from the Bank, the successful bidder, and all no doubt knew that the Bank would ask only its money and expenses."

The distinctions between that case and the case at bar are so apparent as to require no discussion. The court arrived at its decision in view of its findings with reference to the controlling facts above set forth, while affirming (at page 128) its adherence to "the principle that fiduciaries

will not be permitted to profit personally by selling or buying the property committed to their care irrespective of actual fraud."

4. THE DECISION BELOW PROPERLY APPLIES TO PRINCIPLES LAID DOWN IN PEPPER vs. LITTON, 308 U. S., 295, AND THE WELL SETTLED PRINCIPLES OF EQUITY AS DECLARED BY THIS COURT WITH REFERENCE TO A DIRECTOR'S DUTY OF LOYALTY.

Petitioner cites the case of *Sanford Fork & Tool Co. vs. Howe, Brown & Co.*, 157 U. S., 312 (1894), in which case this Court had under consideration the validity of a mortgage given by a corporation at a time when its assets may not have been equal at cash prices to its indebtedness, although it was still a going concern, to protect its directors against loss on account of the continuance and renewal of their personal guaranties of the corporation's notes. It was held that the mortgage was valid and enforceable by the directors to protect them from loss on notes which they had endorsed and had taken up for the protection of their corporation's business. There was no question of directors enforcing the mortgage against their corporation for more than they had paid, or making a profit on their corporation's property.

In our case the Circuit Court of Appeals did not deny the Petitioner reimbursement for the amount actually paid, with interest. It merely denied Petitioner a right to make a *profit over and above its investment and interest thereon* on a claim which had been purchased at a sale at which a majority of the Board of Directors of the Debtor were interested in the purchaser and at which the Debtor had no representation. The decision of the court below, far from undermining a director's duty of loyalty as asserted by Petitioner, merely applies the principle that before a director is in a position to act independently for himself in a manner adverse to his corporation, he must make sure

that his corporation has adequate independent representation, full notice of the sale and of all facts with reference to the director's connection with the purchaser or otherwise which might influence the corporation or its stockholders or creditors to action or inaction in connection with the sale, and must further pay a fair price for the claims or assets purchased.

For the purpose of this petition, Petitioner admits that it stands in the shoes of the Van Sweringens and is in no better position to enforce its claim for an amount larger than its investment and interest than the Van Sweringens would be if they had personally purchased the bonds at the Morgan sale. (Petition, page 3, footnote.) Petitioner further admits that the Van Sweringens undoubtedly controlled the Debtor. (Petitioner's Brief, page 14.) No claim has been made that the Van Sweringens made any effort to provide the Debtor with independent representation for the purposes of the sale or that they brought to the attention of the Debtor or its creditors the fact that they were associating themselves with a prospective purchaser and were therefore financially interested in having the sale price be as low as possible, instead of as high as possible as required by the interests of the Debtor and its creditors. Furthermore, it is admitted that the value on the basis of market quotations of the listed securities purchased by Midamerica at the Morgan sale was $5,745,219.63 (R. 39, 307) in comparison with the sale price of $3,121,000. (R. 37-38) and that there were numerous securities included in the sale which had no market value, among which were the bonds on which Petitioner bases its claim which is here in issue. No effort whatsoever was made to support the reasonableness of the price paid for the securities purchased at the sale, or to overcome the inference of unfairness arising from the fact that the market price of the listed securities included therein exceeded the sale price by more than $2,600,000., otherwise than by showing that the sale

was made at public auction of which the usual formal notice had been given.

The mere fact that a director's purchase was made at a public sale does not sustain the burden which rests upon him of showing that he paid a fair price for property of the corporation with reference to which he owes a fiduciary duty to see that the corporation receives an adequate consideration.

Geddes v. Anaconda Mining Co., 254 U. S., 590 (1920). In that case this Court said at page 601:

> "As an original proposition, we cannot think that the amount offered for property at a public sale for cash, is such a measure of its value that the failure to obtain a bid at such sale for more should be accepted by courts as a sufficient reason for affirming a sale for a price which they found, on other evidence, to be inadequate. In business life forced sales for cash are such a last resort for obtaining money that a sale 'under the hammer' is synonymous with a sale at a sacrifice and prices obtained at such sales have usually been rejected by courts when tendered as evidence of value."

The decision below merely applies the well settled principles of equity declared by this Court in *Pepper vs. Litton*, 308 U. S. 295 (1939) and other decisions, to the facts of this case as found by the Special Master, the District Court and the Circuit Court of Appeals. No other decision could be rendered on the facts as found without undermining the directors' duty of loyalty.

5. PETITIONER CONFUSES THE RIGHT OF A DIRECTOR TO PROTECT HIMSELF AGAINST LOSS IN A TRANSACTION ENTERED INTO FOR THE BENEFIT OF HIS CORPORATION WITH A SUPPOSED RIGHT TO MAKE A PROFIT AT THE EXPENSE OF HIS CORPORATION AND ITS CREDITORS WHICH WILL COMPENSATE HIM FOR LOSSES OTHERWISE SUFFERED.

Petitioner attempts to arouse sympathy with the plight of the Van Sweringens and to justify their making a profit on claims and securities purchased at the Morgan sale by referring to the large losses with which they appeared to be threatened by reason of their investment in the stock of Vaness and their guaranty of the loan of the Debtor and Vaness. Petitioner insists that on account of these prospective losses the Van Sweringens were entitled to protect their own interests by acquiring the securities to be sold at the Morgan sale at the lowest possible price. In developing this phase of its argument Petitioner fails to distinguish between the right of a director to protect himself against loss on a transaction entered into for the benefit of his corporation and a supposed right to make a profit at the expense of his corporation and its creditors which will compensate him for a loss otherwise suffered in transactions entered into with reference to the corporation's affairs. This distinction is important.

Authorities cited by Petitioner lay down the principle that where a director has loaned money to his corporation, for instance, and taken a mortgage on the corporation's property to secure that loan, he is entitled to enforce the mortgage and buy in the property at a foreclosure sale, *provided full notice is given to other interested parties so that they may protect their positions, knowing that the director is acting independently in his own interest and can not be relied upon to protect theirs, and provided further that the director pays a fair price for the property at the sale.* This is a very different proposition, however, from saying that if a director is threatened with the loss of

money arising out of his investment in the stock of an insolvent corporation, or out of a guaranty of the corporation's obligations to some creditor, he may, for that reason, buy property of the corporation or a claim against the corporation for an inadequate consideration and without adequate independent representation of the interests of the corporation and its other creditors, and thereby make a profit at the expense of the corporation and its creditors which he can set off against the loss he has suffered, or expects to suffer, on his stock investment or his guaranty.

It is evident that the interest of the Van Sweringens as guarantors of the Debtor's obligation was to have the pledged securities sold for as large a price as possible so as to reduce the deficiency and their consequent liability on their guaranty. But as soon as they appeared in the role of purchasers, their interest was to have the pledged securities sold for as small a price as possible so as to increase the profit they could subsequently make on a resale or continued holding. The two roles are inconsistent and should never be confused.

When the question before us is whether the director acquired property of his corporation or a claim against his corporation charged with a trust to account to the corporation or its creditors for any profit which he may make upon the same, the result is not affected by preceding transactions in which the director may have been involved which may have caused him to lose money or to face the probability of later losing money, any more than it would be affected by preceding transactions in which the director was involved which resulted in a profit to him in connection with the corporation's affairs.

The very reason for the rule establishing a fiduciary duty in the director's dealings with the properties and rights of his corporation, especially when the corporation has become insolvent and the rights of creditors as well as the rights of stockholders are involved, is the natural

conflict of interest between the director as a creditor or purchaser of property of the corporation, and the other stockholders and creditors of the corporation, and the fact that he is in a position to profit at the expense of other stockholders and creditors if he is permitted to "protect his own interests" without regard to the interests of other stockholders and creditors. The director has no more right to protect his own interests where his previous connection with the corporation has turned out badly for his own financial interests, than where that connection has turned out well. In fact his fiduciary obligations are enlarged when the corporation has become insolvent while he is a director, and he is then held to the utmost good faith in protecting the interests of creditors as well as stockholders, and should not be allowed to make any profit out of the situation which will tend to reimburse him for a part of the losses he may have suffered otherwise, while leaving other creditors to bear their losses in full, enlarged by his failure in his fiduciary capacity to realize as much as possible on the corporation's assets, or to reduce as far as possible its obligations, for the benefit of all creditors.

Recognition of the distinction between protecting a director against loss on the particular transaction into which he has entered for the benefit of his corporation, and permitting him to make an otherwise unjustifiable profit which he may set off against losses from other transactions, will go far to reconcile what might otherwise seem like conflicting decisions.

CONCLUSION.

It is respectfully submitted that this Court should deny Midamerica's petition for a writ of certiorari because (a) there is no conflict between the decision below and other decisions of this Court or any other Circuit Court of Appeals or any State Court whose decisions could be considered applicable to the present controversy and

(b) because the decision below correctly applies the principles of law with reference to the fiduciary obligations of directors to the facts as found by the Circuit Court of Appeals, the District Court and the Special Master.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 614

IN THE MATTER OF
THE VAN SWERINGEN CORPORATION,
Debtor,

and

THE CLEVELAND TERMINALS BUILDING COMPANY,
Subsidiary Debtor.

THE TERMINAL AND SHAKER HEIGHTS REALTY COMPANY (FORMERLY MIDAMERICA CORPORATION),
Petitioner,

vs.

THE CLEVELAND TERMINALS BUILDING COMPANY,
Respondent.

(A. B. GOCHENOUR, ET AL., *Intervenors.*)

BRIEF OF INTERVENORS, A. B. GOCHENOUR, ET AL., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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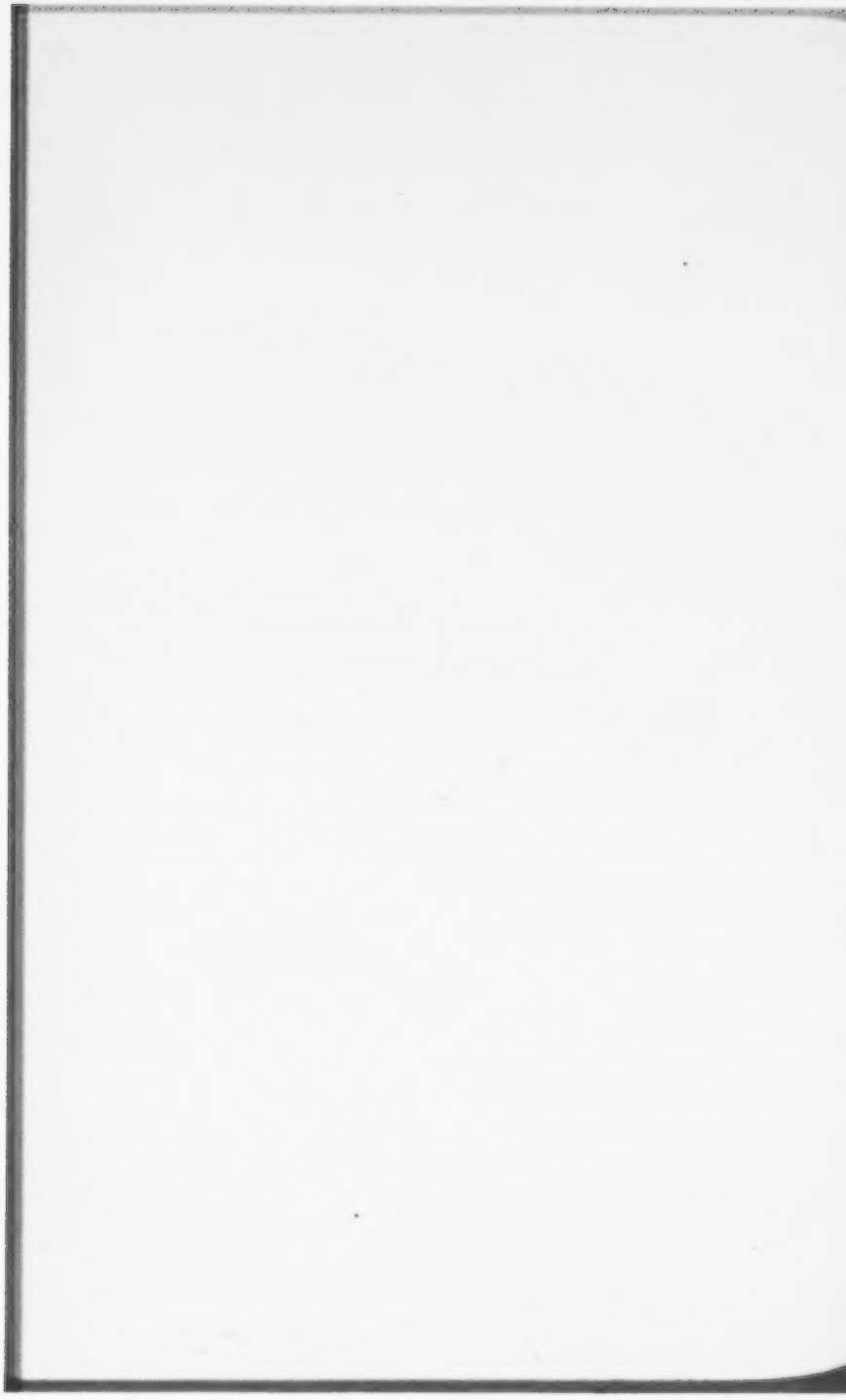

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BRIEF OF INTERVENORS, A. B. GOCHENOUR, ET AL., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

STATEMENT.

Petitioner, Midamerica, filed a claim for $1,348,614.99 in 77B proceedings of Van Sweringen Corporation, debtor, and The Cleveland Terminals Building Company, subsid-

iary debtor, on account of bonds of the subsidiary debtor, which bonds were acquired by petitioner on September 30, 1935, for an investment of $2.00. Intervenors, as creditors, filed objections to the claim on August 27, 1937. (R. 292) Thereafter on May 9, 1938, objections to the claim were also filed by counsel for the subsidiary debtor. (R. 26)

The Circuit Court of Appeals affirmed the judgment of the District Court which adopted the recommendation of the Special Master and allowed the claim in the sum of $2.00 with interest at 6% per annum from October 1, 1935, on the ground that Midamerica was a combination in corporate form, participated in by directors of the respective debtor corporations, formed and utilized for the purpose, among other things, of divesting the debtor corporations of their properties or of obtaining claims against them at a sacrifice for the profit of the combination at the expense and to the detriment of the insolvent debtor corporations; that there was bad faith and breach of fiduciary duty; that Midamerica acquired and holds said bonds so purchased by it as trustee for the subsidiary debtor and therefore is not entitled to more than $2.00, the amount paid, together with interest thereon.

The Formation of Midamerica and the Purchase at the Morgan Auction.

The Van Sweringen brothers, O. P. and M. J. Van Sweringen, were officers and directors of the debtor, the subsidiary debtor and all of the interlocking corporations affiliated with them. C. L. Bradley was president of the subsidiary debtor. M. J. Van Sweringen was its Vice President. C. L. Bradley was also vice president of the debtor corporation, Van Sweringen Corporation, and treasurer of The Vaness Company, the top holding company. M. J. Van Sweringen was also vice president of The Vaness Company and of Van Sweringen Corporation. O. P. Van Sweringen was president of The Vaness Company and

of Van Sweringen Corporation. A complete list of the directors and officers of The Vaness Company, Van Sweringen Corporation and The Cleveland Terminals Building Company is attached to the stipulations as Exhibit K. (R. 42 to 47)

Early in August, 1935, O. P. Van Sweringen requested financial assistance from G. A. Tomlinson, who introduced O. P. and M. J. Van Sweringen to George Ball of Muncie, Indiana. The Van Sweringens informed Ball of the proposed auction of the securities pledged with J. P. Morgan & Co. as collateral for the loans of their company and appealed to Ball for financial assistance. As a result of the conferences and negotiations which followed, Midamerica Corporation was organized by the Van Sweringens and their attorneys for the very purpose of acquiring the securities to be sold at the auction sale on September 30, 1935. (R. 34 and 35; stip. 26, 27, 28, 29, 30; and Ex. S, R. 60)

Petitioner now attempts to show that the Van Sweringens did not control Midamerica and, at page 7 of their petition, they state:

> "Thus although the Van Sweringens were the chief officers" (of Midamerica) "they did not—and could not—control the board."

It appears too obvious that the contrary is true, as found by the courts below. The Van Sweringens, without investing one cent, acquired voting control of Midamerica for a period of ten years; procured an option to buy 55% of its stock for $8250 plus 5% interest; and assured themselves of a salary of $100,000 per year for the ten year option period. (R. 61, Par. 3) Fifty percent of the personnel of the board was named and controlled by the Van Sweringens. The Van Sweringens were elected as corporate officers of Midamerica. No change could be made without a consent of five out of six members of the board. Thus a permanent control was vested in the Van Sweringens over the affairs of Midamerica. Furthermore, it

required a vote of five of the six directors to make changes referred to at page 7 of the petition. Since the Van Sweringens always controlled three of the directors that was tantamount to control.

Cost to Midamerica.

The bonds which are the subject of petitioner's claim in this proceeding were entered by Midamerica on its journal as having been purchased at the auction sale for $2.00. (R. 94, 95, 96, and Ex. Z1 and Z2)

Now petitioner contends that these entries were arbitrarily assigned for purposes of accounting, although no effort was made by petitioner-claimant to disclose any other figure as being the true price paid or allocated therefor.

The record will not lend itself to any theory contrary to the facts stipulated as to the allocated cost of the securities in question.

As shown by the record and as appears from Appendix A, pages 30 and 31 of petitioner's brief, among the securities in Group 1 and Group 3 purchased by Midamerica at said auction sale were securities which, on that date, had listed market prices totaling $5,745,219.63. (R. 152)

20,000 shares of Cleveland Railway stock, acquired in Group 1, were later sold at $60.00 per share, and 20,383 shares were sold at $65.00 per share. (R. 40, Stip. 47) Part of the assets purchased in Group 1 and Group 3 were sold by Midamerica at the price of $6,375,000. (R. 180) Thus Midamerica received a total of $8,899,895, which, after deducting a total investment of $3,121,000, left a profit of $5,778,895.

ARGUMENT.

Petitioner contends that the decision below is in conflict with decisions of the Circuit Courts of Appeals in the Second and Fifth Circuits and that the decision conflicts with applicable decisions of this court.

Petitioner also asserts that if the conflict with Circuit Court of Appeals for the Second Circuit relates to a question which is controlled by state law, the decision below is probably untenable and is in conflict with the state law.

1. There Is No Conflict in the Decision Below With the Applicable Decisions of This Court or With the Decisions of Other Circuit Courts of Appeals.

The cases relied on by petitioner do not hold contrary to the principles asserted by the court below. The law as applied to the facts in the case at bar is in conformity with well settled legal principles uniformly adopted by both state and federal courts.

In *In re New York Railways Corporation*, 82 F. (2d) 739 (C. C. A. 2, 1936), (cited in petitioner's brief as the Second Circuit case with which the present decision conflicts), the facts found with reference to bad faith and fiduciary duty were exactly contrary to the facts found in the case at bar. At page 14 of petitioner's brief opposing counsel recognize one important distinction between the facts in the New York Railways case and those in the case at bar to be that the board of directors of the subsidiary company in the *New York Railways* case "was independent and that there was no ground to infer from its action any improper influence by the parent."

That the *New York Railways* case was carefully considered and distinguished in several respects is clear from what the District Court stated in its opinion in the case

at bar (R. 257), and as there stated "no parallel or analogy is found as between New York Railway Corporation and the Fifth Avenue Coach Company and these debtors and the Van Sweringens." The following points of distinction were thereupon indicated:

1. The Fifth Avenue Coach Company had no fiduciary relationship to the New York Railways Corporation, debtor.

2. It did not have the management of the debtor.

3. It had a majority of independent directors.

4. The Van Sweringens dominated and controlled the debtors.

5. The Van Sweringens were the chief officers, directors and stockholders.

6. Van Sweringen Corporation and The Cleveland Terminals Building Company were an integral part of the Van Sweringen interlocking enterprises.

7. The Van Sweringens were the principal officers of Midamerica, the purchaser and claimant.

From the record in the case at bar a distinction is just as real as it is apparent.

In *Arn* v. *Bradshaw Oil & Gas Co.*, 108 Fed. (2d) 125 (C. C. A. 5, 1940), (cited at page 24 of petitioner's brief as the Fifth Circuit case relied upon as being in conflict with the decision in the instant case), the facts likewise were different from those in the case at bar. There the directors did not misuse their position to obtain the challenged result; no director brought about the sale or contributed to it. All of the directors did their best on behalf of their corporation prior to the sale; all parties had the same opportunity to purchase the property. For these and other reasons disclosed by the opinion in the *Arn* case, as differing from the facts in the case at bar, there was no violation of the well established principle involving an inhibited area of bargaining and breach of fiduciary relationship as the facts in the case at bar present.

The opinions in the cases decided by the Second and Fifth Circuits indicate complete accord with the decision in the case at bar, and not a conflict as is claimed by petitioner.

In *Twin-Lick Oil Co.* v. *Marbury,* 91 U. S. 587, cited by petitioners, although the facts were entirely different from those in the case at bar the court said, at page 590:

> "So, when the lender is a director, charged, with others, with the control and management of the affairs of the corporation, representing in this regard the aggregated interest of all the stockholders, his obligation, if he becomes a party to a contract with the company, to candor and fair dealing, is increased in the precise degree that his representative character has given him *power and control* derived from the confidence reposed in him by the stockholders who appointed him their agent. If he should be a sole director, or one of a smaller number vested with certain powers, *this obligation would be still stronger,* and his acts subject to more severe scrutiny, and their validity determined by more rigid principles of morality, and freedom from motives of selfishness." (Italics ours.)

In the instant case the Board of Directors were more than "influenced to inaction and silence." A majority of them actually participated in the formation of Midamerica Corporation!

The rule announced by this court in *Pepper* v. *Litton,* 308 U. S. 295, was properly followed by the court below notwithstanding the unmerited criticism by petitioner that there was an over-zealous application of the principles there enunciated by this court, even to the extent that the result may lead to undermining a director's duty of loyalty—a virtue which was wholly disregarded by the Van Sweringens and their associates. The rule announced in *Pepper* v. *Litton* was reiterated by this court in *Sampsell* v. *Imperial Paper & Color Corporation,* 313 U. S. 215, 61 S. Ct. 904, 85 L. Ed. 797. Mr. Justice Douglas, speaking on behalf of the court, stated (page 218):

> "Mere legal paraphernalia will not suffice to trans-

> form into a substantial adverse claimant a corporation whose affairs are so closely assimilated to the affairs of the dominant stockholder that in substance it is little more than his corporate pocket. Whatever the full reach of that rule may be, **it is clear that a family corporation's adverse claim is merely colorable where, as in this case, the corporation is formed in order to continue the bankrupt's business, where the bankrupt remains in control, and where the effect of the transfer is to hinder, delay or defraud his creditors.** *In re Schoenberg*, 2 Cir., 70 F. 2d 321; *In re Berkowitz*, D. C., 173 F. 1013. And see Glenn, Liquidation, §§ 30-32. Cf. *Shapiro* v. *Wilgus*, 287 U. S. 348, 53 S. Ct. 142, 77 L. Ed. 355, 85 A. L. R. 128." (Bold type supplied.)

Compare this with the opinion of the trial court in the instant case (R. 258):

> "Under the option and purchase arrangement, if the Van Sweringens died or failed to satisfy their creditors within ten years, Ball and Tomlinson took all. **It was a mutually satisfactory arrangement for their common protection against those who might try to pursue the Van Sweringen fortunes through the intricate maze of corporate entities.** Thus, it assured control to the Van Sweringens without creditor interference and gave to Ball and Tomlinson, their associates, freedom from the threat of stranger majority in control of the voting stock. **The option was just what it was intended to be, a device for placing the Van Sweringens' interests in the purchased securities and obligations beyond the reach of their and these debtors' creditors.**" (Bold type supplied.)

The decision of the Sixth Circuit which affirmed this decision is therefore in accord with the views of this court.

2. The Decision in This Case Is Not Untenable or in Conflict With State Laws.

Petitioner's contention on this point is very weak. The New York law on which petitioner relies for probable conflict is the rule announced in *Tiffany* v. *Smith*, 124 N. Y.

Supp. 85, which petitioner says (p. 20) is "the only New York case on the subject." That case involved a sale by a *receiver* and there was no question about failure to give notice to creditors, and the directors did not stand in a fiduciary position to creditors. The *Tiffany* case is cited in *Herring* v. *Curtiss,* 200 N. Y. Supp. 7, 48 on the point that the directors were absolved from a breach of the trust but that decision was *reversed* on appeal in 233 Appellate Division, page 101. The *Tiffany* case relied on cited the decision in *Marr* v. *Marr,* 72 N. J. Equity 797, but it overlooked that the New Jersey Court of Errors *reversed* the decision in 70 Atlantic 375. There it said (page 378):

> "But we deem it clear that the director, who is also creditor, must, on taking legal proceedings for collection of his debt, relinquish his trust *pro hac vice,* not covertly, but openly, and with fair notice to his company. Whether such notice should be given to the stockholders or to the directors may depend upon circumstances. If the company is equipped with other officers and directors who are actively representing the interest of the stockholders, it may well be that notice to such officers or directors would be deemed sufficient. But it is, as we think, inconsistent with the duty of a director (at least under circumstances such as are here presented) that he should assume an attitude antagonistic to his company, unless he sees to it that the interests of the stockholders, which he, by reason of his personal interest, is for the time disqualified from protecting, are in the charge of other officers and directors able and willing to protect them, and to whom his notice may be given, or else sees to it that fair notice of his contemplated action be given to the stockholders, so that they may take measures to protect themselves."

The rule was followed in *Endicott* v. *Marvel,* 87 Atl. 230 and in *Union Ice Co.* v. *Hulton,* 291 Pa. 416, where the director purchased at a "public sale". In the latter case the court cited the *Marr* case, *supra.*

Notwithstanding the statement that the *Tiffany* case is the "only" New York case on the right of a director-credi-

tor to purchase the property of his corporation to protect his creditor's position without notice to the corporation or to its creditors in the event of insolvency, *the contrary appears* in *Claude Neon Lights* v. *Fed. Electric Co.*, 295 N. Y. S. 1-6, 250 App. Div. 510 (1937). See also *Lonsdale* v. *Speyer*, 291 N. Y. S. 495, 249 App. Div. 133 cited in the opinion. (R. 307.)

Even in cases where the director-creditor may become a purchaser in order to protect his creditor's position, he must "warn the corporation" that he would "bid" and afford it the opportunity to protect its rights (*Wilson* v. *Thelan*, 100 P. (2) 923 (Mont. 1940). There it was said (page 927):

> "Where there is a forced sale of corporate property *a director who is also a creditor who warns the corporation that he is about to do so, may bid* upon the property without being charged improperly taking an interest adverse to the corporation." (Italics ours)

No such "warning" was given in the instant case. The authorities on this point are collected in 76 A. L. R. pp. 454-455.

No Ohio case is cited as being in conflict with the decision of the Circuit Court of Appeals in the instant case, and none can be cited because the Ohio courts enforce the rule against dishonest or double dealing and do not sanction the fraudulent purchase of corporate property by directors of corporations. The Ohio courts always subject such purchases to the closest scrutiny and adhere to the principles discussed in 13 American Jurisprudence, page 960, § 1009, under title "Corporations," from which the following is quoted:

> "In order, however, that a director purchasing his company's property at a judicial or other public sale may acquire a valid title, it is necessary that parties interested or affected thereby shall have a sufficient notice of the sale in order that they may have an oppor-

tunity to bid, if they desire. Furthermore, in those jurisdictions where the purchase of corporate property at a judicial or other public sale by an officer or director of the corporation is upheld, *provided the transaction is accomplished with good faith* and full disclosure of the facts, the burden of establishing the bona fides of the transaction is upon the purchaser. The validity of the sale is affected by the adequacy or inadequacy of consideration, and *a purchase at a grossly inadequate price is very strong, if not almost conclusive, evidence of fraud or bad faith.*" (Italics ours)

If the New York law be applicable here as contended by petitioner, then, *the rule announced in the McCrory case* (12 F. S. p. 267) *was adopted in New York* (*Claude Neon Lights* v. *Federal Electric Co.*, 295 N. Y. S. 1, 250 App. Div. 510). There, the court said (page 517):

"In Fletcher's Cyclopedia of Corporations (Permanent ed. § 869) it is stated that the general rule is that directors or other officers may purchase, and enforce, claims against their corporations, at their face value, notwithstanding they were bought at a discount, provided, however, that (1) if such officer owed the duty to his company to purchase the claim for the company instead of for himself he cannot enforce his claim in excess of what he paid for it, and, according to what is apparently held in a few decisions, that (2) if a corporation is insolvent at the time of the purchase the officer cannot enforce his claim for more than he paid for it. The rule is reiterated in *Matter of McCrory Stores Corporation* (12 F. Supp. 267), where it is said: 'Under ordinary conditions a director may purchase claims against his corporation at a discount and enforce them for their full amount. (*Seymour* v. *Spring Forest Cemetery Association*, 144 N. Y. 333; 39 N. E. 365; 26 L. R. A. 859; *Glenwood Mfg. Co.* v. *Syme*, 109 Wis. 355; 85 N. W. 432; Fletcher on Corporations, § 2289.) *But the case is different where the corporation is insolvent and is itself in the field to settle the claims. A director who acquires claims under such circumstances may enforce them for no more than the cost of acquisition.*' "

See also *Billings* v. *Shaw*, 209 N. Y. 265 and *Jno. Dunlop's*

Sons v. *Dunlop*, 14 N. Y. S. (2) 452 (1940). There the court said (page 453):

> "Directors may not act in a dual capacity to their individual advantage. Silence when speech is imperative, concealment when disclosure is necessary, disloyalty when faithfulness is indicated, constitute breaches of fiduciary relationship for which relief in equity may be had."

Such relief was given under the rule that a court of Bankruptcy is essentially a court of equity (*Pepper* v. *Litton*, 308 U. S. 295).

Notwithstanding the bold effort of petitioner to secure the aid, approval and blessing of a federal court of equity of such unjust enrichment, the facts disclosed by the record in the case at bar are too conscience shocking for any court to be lured into such approval or deviation from established standards of morality.

Conclusion.

It is clear that the decision of the United States Circuit Court of Appeals for the Sixth Circuit, in the instant case, followed the well settled applicable legal principles, universally accepted, in affirming the judgment of the District Court and the findings of the Special Master. Justice has been done in accordance with equity and good conscience.

The petition for writ of certiorari should, therefore, be denied.

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